

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Demand Response and Advanced Metering

Docket No. AD06-2-000

TECHNICAL WORKSHOP
January 25, 2005

TESTIMONY OF RICHARD S. TEMPCHIN
ON BEHALF OF
THE EDISON ELECTRIC INSTITUTE

Good morning. I am Rick Tempchin, Director of Retail Distribution Policy for the Edison Electric Institute (EEI). EEI appreciates the opportunity to address the Commission and staff today on demand response and advanced metering in response to the Notice of Proposed Voluntary Survey and Technical Conference (“Notice”) issued by the Commission on November 3, 2005 and December 12, 2005 regarding issues raised by the Energy Policy Act of 2005 (EPAcT 2005) section 1252(e)(3). We commend the Commission and the staff for convening this conference before finalizing the report that assesses demand response resources. We believe that it is very important to discuss the issues raised by EPAcT in an open forum with participants from a wide range of perspectives.

EEI supports policies and programs that promote customer participation in demand response options by encouraging customers to discover the value of demand response. We continue to agree with the Commission’s statement in its 2002 working paper that demand response “... is essential in competitive markets to assure the efficient interaction of supply and demand.”¹

¹ See FERC Working Paper on Standardized Transmission Service and Wholesale Electric Market Design, Docket No. RM01-12-000 at 6 (Mar. 15, 2002).

I would like to briefly discuss two issues: first, the issues of treating demand response as a resource, and second, the issue of subsidies for demand response.

RESOURCE CONTRIBUTION

The Commission may wish to revisit its definition of resource contribution. In the Notice, resource contribution is defined as “potential peak reduction at time of system peak.”² There are two reasons to do this. The first is whether demand response should-or even can be-viewed as a resource in the same way that supply resources are viewed. That is, whether it makes sense when a customer reduces his or her demand in response to a price signal, to somehow equate that response to supply resources, or whether such policies will disrupt markets by confusing demand and supply resources.

Second, this definition appears to refer to an earlier time in which electric utilities operate largely as islands, and needed to secure resources to meet the anticipated level of maximum demand of their customers (system peak), plus an adequate reserve margin. However, with the advent of wholesale competition and organized regional power markets, utilities can purchase resources from outside of their system when they are needed or economic. In these areas, the issue of resource adequacy has moved to the regional level. Requiring utilities to set specific resource targets may actually be a constraint on the utilities in the regions flexibility to find workable market solutions to satisfy their customers’ needs.

The policies that are being contemplated for demand response’s role in today’s markets need a revised framework that is sensitive to near-term operating reserves, system conditions, and the wholesale cost of power at the time that resources are being

² See FERC Assessment of Demand Response Resources, Docket No. AD06-2-000 at 5 (Nov. 3, 2005).

utilized, and where demand response offers the greatest locational advantage. In other words, a region's system peak could occur at a level and under conditions in which ample reserve capacity from supply resources is available, implying that few demand-side resources are needed (or worth paying for). In contrast, system peak could occur at a time of unusually high regional demand and low reserve capacity. Under these conditions, demand response can provide a resource contribution if utilities call on curtailable loads that have been offered as call options, or if the high wholesale costs are passed on to retail customers in the form of real-time prices or demand response program payments, thus producing price-responsive load reductions.

In the context of demand response, the term "resource contribution" needs to be defined relative to some notion of low operating expenses, reduced reliability, or high economic costs of resources involved in providing power, with reference to some normal level. In the context of resource planning, the "system peak" demand used to assess resource adequacy is a forecast level that typically includes a range of uncertainty. Then, supply capacity availability is assessed relative to the forecast peak. Demand response resources may be treated as adjustments to the load forecast or as potential increments to supply capacity to meet the unadjusted peak load forecast. Increasingly, however, the greatest value of demand response may not necessarily occur at the time of system peak. Additionally, the greatest value will be highly differentiated by location.

SUBSIDIES

The issue of subsidies relates to the Commission's questions on resource contribution, demand response potential, and equitable treatment of demand response. For demand response to succeed, it must be market-based, cost-effective and promote

economically efficient pricing. Subsidies for demand-response should not be used, except for certain pilot or research projects. Subsidized increases in demand response come at the expense of increased costs to non-participants, increased overall market costs, wealth transfers between market participants and decreased market efficiency. Thus, subsidies do not promote and maintain full competitive markets, and instead increase market instability.

Demand response should not receive preferential treatment. Rather, it should stand on equal footing with supply-side and transmission resources. However, this does not mean that customers should simply be paid for not consuming power. A reduction in demand is not an increase in supply; it is a reduction in demand. Any payment to a consumer for demand reductions should never exceed the wholesale price minus the retail price that the consumer would have otherwise paid to “own” the power. If customers are to be paid to reduce their demand, as opposed to simply relying on their decisions to buy less when prices rise, then they must own it before they can sell it back. Any payment above this level would be a subsidy, i.e., a non-market payment that has to be recovered through a tax or charge on all customers. There is no reason to distort the market by paying artificial subsidies for demand response.

EEI urges the Commission and staff to focus on resource contribution and subsidies as it finalizes its report. These are two key issues in determining DR potential and equitable treatment of demand response.