123 FERC ¶ 61,021
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

ISO New England Inc. Docket No. ER08-538-000

ORDER ACCEPTING TARIFF REVISIONS

(Issued April 4, 2008)

1. In this order, the Commission accepts proposed changes to the market rules governing ISO New England Inc. (ISO-NE's) day-ahead load response program, effective February 7, 2008.

Background

2. On February 5, 2008, under section 205 of the Federal Power Act (FPA),[1] ISO-NE submitted changes to the market rules governing its Day-Ahead Load Response Program (DALRP) to adjust the minimum offer price from a fixed $50/MWh to an indexed amount that reflects current fuel prices. ISO-NE asserts that it is making this change to prevent DALRP participants from gaming the DALRP system and obtaining payments for load reductions that they are, in fact, not making. ISO-NE also asks for a waiver of the 60-day prior notice provisions of section 205 and section 35.11 of the Commission's rules,[2] so as to make these revisions effective on February 7, 2008, on the basis of "pressing market need."[3]

History of the DALRP

3. The DALRP was included in Market Rule 1[4] as part of New England's Standard Market Design on March 1, 2003 and was implemented on June 1, 2005. The DALRP

[1] 16 U.S.C. § 824d (2000).

[2] 8 C.F.R. § 35.11 (2007).

[3] Transmittal letter, February 5, 2008 filing (transmittal letter) at 2.

[4] Market Rule 1 is Section III of ISO-NE's Transmission, Markets and Services Tariff, FERC Electric Tariff No. 3 (ISO-NE Tariff).

gives a participant in one of ISO-NE' s Real-Time Load Response Programs the opportunity to offer a day-ahead price (in $/MWh) for a firm amount (in MW per hour) of load reduction it is prepared to deliver in real-time should day-ahead Locational Marginal Prices (LMPs) clear at levels that equal or exceed the participant's offer. The offers are made in increments of 100 kW or more, but resources may be aggregated to reach the 100 kW minimum. The minimum DALRP offer as set in 2003 was $50/MWh, and has remained unchanged.

4. Participants whose load reduction offers clear in the DALRP are paid the day-ahead LMP for the amount cleared. If they reduce more in real time than the amount cleared in the DALRP as measured against their Customer Baseline, they are paid for the excess at the real-time LMP. If they reduce less in real time relative to their cleared day-ahead offer, DALRP participants must buy back the difference at the real-time LMP. Load reductions are computed, for purposes of the DALRP, as the difference between a demand response asset's Customer Baseline and the asset's actual load during the hours in which the asset's DALRP load reduction offer was accepted.

5. ISO-NE's Load Response Program (within which the DALRP is only one option) was designed so that the Customer Baseline is dynamic, and changes to reflect changes in usage at the customer's facilities. Load reductions, for DALRP compensation purposes, are calculated by subtracting an offered asset's actual load during a Load Response Event (i.e., a period during which a customer deliberately reduces load due to its participation in ISO-NE's Load Response Programs) from the Customer Baseline. An asset's dynamic Customer Baseline is effectively a 10-day rolling average of interval meter data from days on which no Load Response Event has occurred for the asset. Load Response Event days (which include days on which an asset's offer has cleared in the DALRP) are excluded from the Customer Baseline calculation because the Customer Baseline is intended to represent an asset's normal operating conditions, and it is assumed that the asset will reduce its usage on Load Response Event days.

6. The DALRP anticipated that Market Participants would make offers that reasonably reflected the reductions that their demand response assets could deliver in real-time, at prices that reflected their opportunity costs. ISO-NE explains that in particular, the intent of the $50/MWh minimum offer price for the DALRP was to avoid paying for apparent, rather than real, load reductions. The $50/MWh minimum offer price was designed to be high enough to tie the DALRP's impact to high-price hours, but not so high as to discourage legitimate participation in the program.

ISO-NE's Review of the DALRP

7. ISO-NE states that it noticed a surge in DALRP participation at the beginning of August 2007, and in monitoring the program through the fall of 2007 and analyzing participant bidding behavior, it became clear to ISO-NE that a longer-term trend was emerging.

8. ISO-NE states that, for the period from June 2005 through the early summer of 2007, participation in the DALRP increased at a very modest pace, from two to 20 demand-response assets participating per month. However, since the latter half of August 2007, the number of demand response assets participating in the DALRP has increased significantly,[5] more than doubling since August 31, 2007.[6] Further, while the number of Market Participants participating in the DALRP has increased, the size of a DALRP participant's average offer from year to year has decreased, so that the majority of assets now participating in the DALRP submit load interruption offers at the minimum level allowed by the program rules (100 kW), even though such participants are capable of delivering substantially greater load interruptions in real-time. Furthermore, the trend is that all DALRP participants are offering to interrupt load at the $50/MWh floor price every eligible hour of every weekday.[7]

9. ISO-NE explains it was expected in 2002 that: (i) assets in the DALRP would clear periodically, but not for days on end; and (ii) DALRP assets would clear on high LMP days. However, when the minimum offer price of $50/MWh was first proposed in 2002, New England natural gas prices were less than $4.00/MMBtu and wholesale energy prices exceeded $50/MWh less than 12 percent of the time.[8] Today, natural gas prices are regularly in the range of $7.00 to $10.00/MMBtu and day-ahead LMPs exceed $50/MWh about 84 percent of the time.[9] ISO-NE states that the program was designed so that DALRP offers would clear when supply-demand conditions were producing higher LMP levels and when the supply curve tends to have a steeper slope such that load reductions could significantly reduce market clearing prices and increase net societal benefits.[10] At lower LMPs, however, such as those in today's market, the supply curve in both the day-ahead and real-time energy markets has a very modest slope, meaning that a program that induces demand response at such lower levels would have a small impact on

[5] ISO-NE included in its filing supporting testimony of Henry Y. Yoshimura, ISO-NE's Manager of Demand Resources (Yoshimura Testimony) as Attachment 1 to its transmittal letter in this filing. *See* Yoshimura Testimony, at 9.

[6] ISO-NE provided compliance reports in that docket on the status of the DALRP and efforts to integrate demand resources into the New England energy, reserves and capacity markets.

[7] Yoshimura Testimony at 10.

[8] *Id*. at 11.

[9] LMPs below $50/MWh occur mostly during non-program, off-peak hours – i.e., nights, holidays and weekend. *See id*. at 11.

[10] *See generally id*. at 28, 33-34.

market clearing prices. Hence, even in the absence of strategic behavior, offers clearing at or near $50/MWh result in a cost that other consumers bear, but with little benefit to these other consumers or to society as a whole.

10. ISO-NE asserts that, by making offers every weekday that are keyed to the $50/MWh minimum offer price, DALRP participants are able to engage in strategic behavior that overstates their respective Customer Baselines.[11] As discussed above, an asset's Customer Baseline, calculated using the methodology defined in ISO-NE New England Load Response Program Manual, is intended to be dynamic, and is a 10-day rolling average of interval meter data from days on which no Load Response Event has occurred for the asset. The purpose of a dynamic Customer Baseline is to systematically capture changes in an asset's load, which can change on a daily basis, as a function of factors such as weather and operation schedules. If a participant's DALRP offer is accepted for a single hour, that day is considered a Load Response Event day for that participant. Load Response Event days are excluded from the Customer Baseline calculation because the Customer Baseline is intended to represent an asset's normal operating conditions.

11. ISO-NE explains that excluding the DALRP-cleared days from the Customer Baseline, given the frequency with which assets are currently clearing due to recurrent use of the $50/MWh DALRP offer level, results in a static Customer Baseline, i.e., a Customer Baseline that does not change over time.[12] Static Customer Baselines do not reflect the most recent operating conditions at the facilities participating in the DALRP. For example, the Customer Baseline established for an office building in the middle of August - in terms of load shape and magnitude - would likely be very different from the Customer Baseline for the same facility in the middle of October.

12. ISO-NE further explains that since a static Customer Baseline prevents ISO-NE from being able to accurately determine the true load interruption amounts, the payments made to assets with static baselines are suspect. For example, with the minimum DALRP offer price so low compared with typical day-ahead LMP prices, a DALRP program participant with a load profile that is typically higher in the summer than the winter can forego offering into the program for ten days, establish a high Customer Baseline during those days, and then maintain that baseline by submitting a minimum DALRP offer for every weekday thereafter and be very confident that it would clear in the DALRP every such weekday. The high, static baseline would produce consistent "phantom reductions" for purposes of the DALRP during the non-summer periods, even though the customer is

[11] *See generally id*. at 11-20.

[12] *Id*. at 12-13.

taking no action to reduce its usual consumption levels.[13] ISO-NE further asserts there is clear evidence that some DALRP participants have taken this behavior one step further and intentionally inflated their Customer Baselines in order to collect energy and capacity payments without actually reducing load.[14]

Impact of Participant Behavior

13. ISO-NE states that it is necessary to address this strategic behavior because payments made to demand response assets enrolled in the DALRP are funded by all electricity consumers in the New England Control Area,[15] on the basis that all consumers and society as a whole benefit from real demand response behavior. Such "real" demand response results in actual reductions in real-time electricity demand during high-price hours, which will tend to result in lower LMPs because higher cost generating units and/or shortage conditions are averted. In high-price hours, this is likely to both lower LMPs and increase net societal benefits. ISO NE argues that if, by contrast, the demand

[13] The problem created by static Customer Baselines is not limited to an isolated DALRP participant, as is illustrated in Figure 10 in the Yoshimura Testimony. Over the most recent four-month period, 26 out of 46, or almost 60 percent, of the assets clearing in the DALRP had a static Customer Baseline. The 26 assets with a static Customer Baseline represented 255.0 MW out of 347.8 MW of total DALRP capacity. Thus, almost 75 percent of the amounts (in MW) clearing in the DALRP had a static Customer Baseline over the same four-month period. Four assets had a static baseline for at least 180 days. *Id*. at 22.

[14] For example, ISO-NE has identified an asset that had consistently flat consumption and a Customer Baseline of approximately 12 MW for the period June 2006 through early July 2007, during which the asset's load and Customer Baseline were relatively flat. Up through early July 2007, this asset was not participating in the DALRP program, but in early July it retired from the Load Response Program and then, on July 25, 2007 re-enrolled in the Load Response Program. By retiring and then re-enrolling, the asset was required to re-establish its Customer Baseline. The load data submitted after July 25, 2007 to re-establish this baseline shows a distinctly different profile than the data submitted before retirement – namely, an increased load during the DALRP eligible program hours. The asset's load is flat before and after these hours. The profile is also flat during program hours, but at a level that is approximately 4 MW higher than hours before 7:00 a.m. or after 6:00 p.m. After establishing the new Customer Baseline, this Market Participant entered an offer in the DALRP for the August 1, 2007 operating day of 3 MW at $50/MWh and began clearing every weekday. As a result, the new Customer Baseline has remained almost static since it was first created on July 31, 2007. *See id*. at Fig. 6 and 7 at 17-18*; see generally, id*. at 16-21

[15] *Id*. at 4.

reduction of DALRP participants is merely an artifact of an overstated Customer Baseline and not an actual load reduction, such participants will receive payments, but the wholesale market will be unaffected because there will be no actual reductions in demand to affect the market.

14. ISO-NE also states that the impact of the strategic behavior described above is significant. Both payments under the DALRP, and the number of assets offering into the program, continue to grow. Total DALRP payments have grown almost tenfold from the previous year: in 2006, total DALRP payments were only $1.74 million, while in 2007, participants in the DALRP received payments totaling $16.81 million.[16] Over half of these payments - about $8.7 million - are associated with static Customer Baselines. Moreover, the proportion of payments associated with static Customer Baselines has grown 68 percent from July 2007 through December 2007,[17] and ISO-NE asserts that other Market Participants could copy this behavior: it would be possible for all 1,700 MW of demand response assets that are currently enrolled in ISO-NE's Load Response Program to offer into the DALRP at the $50/MWh minimum offer and create static Customer Baselines in the manner described above.

15. ISO-NE points to other adverse effects of this behavior in addition to potentially exaggerated energy payments. First, an asset's static Customer Baseline also affects the calculation of the asset's performance during reliability events (i.e., calls for demand reduction due to emergency conditions) and the associated capacity value that the asset is considered to bring to the system. Illusory load reductions can thus inflate capacity payments because, as explained above, the same Customer Baseline used in the DALRP is also used to determine the Capacity Value of a Real-Time Demand Response assets participating in the DALRP. Second, for purposes of operations and planning, an overstated Customer Baseline creates the illusion that a larger amount of demand response is available for interruption during a real-time system emergency than is the case. System operators rely on a particular amount of demand response to materialize in real-time to alleviate a capacity deficiency, so they need an accurate picture of the system resources available to them in real-time. From the perspective of system planning, exaggerating the real-time capability of demand response resources could result in the under-procurement of other capacity resources to ensure long-term resource adequacy.[18] Thus, the program is not having its intended effect of reducing demand and improving market efficiency.

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[16] *Id*. at 22.

[17] *Id*. at Figure 11.

[18] *Id.* at 24.

16. And finally, ISO-NE contends that the impact of reduced demand on the market is greatest during high-price hours when the supply curve is steeply sloped. At lower LMPs, such as in the range of $50/MWh in today's market, the real-time supply curve has a very modest slope and demand response at such lower LMPs accordingly has a small impact on market clearing prices. Therefore, ISO-NE stresses that even in the absence of strategic behavior, DALRP offers clearing at or near $50/MWh could result in net societal losses by giving DALRP participants an incentive payment to reduce load even when the marginal cost of electricity is low.[19]

Notice of Filings

17. Notice of ISO-NE's May 15 filing was published in the *Federal Register*, with motions to intervene, notices of intervention, comments and protests due by February 15, 2008.[20] The Industrial Energy Consumer Group (IECG), EnerNOC, Boston Generating, LLC *et al*., Dominion Resources Services, the New England Power Pool Participants Committee (NEPOOL), New England Power Generators Association (NEPGA), Mirant Parties, NRG Companies, NEPOOL Industrial Customer Coalition, NUSCO, BG Energy Merchants *et al.* (BG Entities), and Exelon filed timely motions to intervene. PSEG Power Companies (PSEG) filed a motion to intervene out of time and the Maine Public Utilities Commission (Maine Commission) and the Connecticut Department of Public Utility Control (CT DPUC) filed notices of intervention out of time.

18. EnerNOC and IECG filed preliminary protests requesting that the Commission deny ISO-NE's request for a waiver of the 60-day notification requirement, and enjoin ISO-NE from putting into place its revised tariff provisions until after the Commission ruled on the filing. ISO-NE filed an answer to EnerNOC's and IECG's protests regarding procedural issues on February 11, 2008.

19. EnerNOC and IECG then filed supplemental protests addressing the substance of ISO-NE's February 5 filing,[21] and NEPOOL, the NRG Companies, BG Entities and CT CPUC filed comments. On February 15, ISO-NE filed an answer to IECG's and EnerNOC's substantive protests, and on February 28 NEPOOL also filed an answer to IECG's substantive protest. On February 19, IECG then filed an answer to ISO-NE's February 15 answer. ISO-NE then filed an answer on March 3, and on March 7 IECG filed an answer to ISO-NE's March 3 answer.

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[19] *See generally id*. at 28, 33-34.

[20] 73 Fed. Reg. 8305 (2008).

[21] IECG filed protests regarding the substance of ISO-NE's proposal on February 8 and February 15, and EnerNOC filed a protest regarding the substance of ISO-NE's proposal on February 15.

Discussion

Procedural issues

Intervention and Answers

20. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214 (2007)), the notices of intervention and the timely-filed unopposed motions to intervene serve to make the entities filing them parties to this proceeding. The Maine Commission's and CT DPUC's motions to file a notice of intervention out-of-time and PSEG's motion to intervene out-of-time are granted, given the early stage of the proceedings, the parties' interest and the absence of undue prejudice or delay.

21. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept all of the answers filed by the parties, because they have provided information that assisted us in our decision-making process.

Waiver and Injunctive Relief

22. As noted above, ISO-NE made this filing on February 5, 2008. In that filing, it notified the Commission that it would put the tariff revisions into effect on February 7, 2008, so that the revisions would be effective for day-ahead offers submitted on February 7 for the February 8, 2008 operating day. To enable the revisions to go into effect two days after filing, ISO-NE requested a waiver of the requirement that it file notification of a rate change 60 days in advance,[22] and also stated that "[s]hould the Commission reject the DALRP Revisions, the ISO respectfully requests that any rejection be prospective in nature and that no refunds be ordered for the intervening period because it will not be possible to reconstruct market outcomes for that interim period."[23] EnerNOC and IECG oppose the waiver of the 60-day notice provision. They also ask the Commission to prevent ISO-NE from implementing its proposed tariff changes until the Commission approves the proposal, and/or to enjoin any changes ISO-NE has already made.

23. In *Central Hudson Gas & Elec. Corp*., the Commission provided guidance as to what constitutes "good cause" for granting a waiver of the 60-day notification provision,

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[22] Under section 205 of the FPA, a utility must file notice of a rate change 60 days before the new rate can go into effect. However, section 205 also allows the Commission to waive the notification requirement "for good cause;" *see also* the Commission's rules at 8 C.F.R. § 35.11.

[23] Transmittal letter at 2.

stating that "[w]e will generally grant waiver of the 60-day prior notice requirement [where] . . . filings [] reduce rates and charges -- such as rate decreases or new services that provide the customer of a utility with an opportunity to reduce its purchases of other, more expensive service from the same utility."[24]

24. The Commission grants ISO-NE's request to waive the 60-day notification requirement here. The Commission has previously waived the 60-day requirement to protect customers from the adverse effects of market dysfunctions. ISO-NE recently filed an emergency revision to its tariff so as to preclude opportunities for market manipulation with regard to the scheduling of export and import offers. The Commission accepted the emergency revision and granted a waiver of the 60-day notice provision to allow ISO-NE's filing to go into effect the day after the filing was made.[25] ISO-NE also cites to other cases in which waiver of the 60-day notice provision was granted to protect customers from market dysfunctions[26] or the exercise of market power.[27]

25. Here, ISO-NE's application for waiver of the 60-day prior notice provision states that "failure to approve this adjustment promptly could perpetuate inappropriate levels of payments to certain DALRP participants, which undermines the integrity of the overall demand response program operated by ISO-NE. Expedited consideration . . . [is] necessary to protect the integrity of the DALRP,"[28] and that "[i]t is essential that [the alleged gaming behavior] be addressed immediately to prevent further inappropriate payments, and to protect the integrity of both the demand response industry and the

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[24] 60 FERC ¶ 61,106, at 61,338, *reh'g denied*, 61 FERC ¶ 61,089 (1992).

[25] *ISO New England Inc*., 122 FERC ¶ 61,057 (2008).

[26] *California Independent System Operator (CAISO)*, 111 FERC ¶ 61,008 (2005) (accepting interim solution to the problem of Scheduling Coordinators causing CAISO to incur excessive costs as a result of the manner in which import and export bids from system resources are cleared and settled, effective one day after filing); *ISO New England Inc*., 112 FERC ¶ 61,301 (2005) (accepting effective date one day after filing market rule changes to correct a market rule flaw to reduce the number of minimum generation Emergencies and to provide more incentive for generators to follow ISO-NE's dispatch instructions during minimum generation emergencies).

[27] *NSTAR Servs. Co. v. New England Power Pool*, 92 FERC ¶ 61,065 (2000) (accepting effective date six days after tariff amendment was filed to extend price cap rules beyond date it was set to expire); *ISO New England Inc*., 93 FERC ¶ 61,248 (2000) (accepting request to extend bid cap, effective the date of the filing, and issuing the order two weeks after the bid cap would have otherwise expired).

[28] Transmittal letter at 2.

wholesale electricity markets."[29] ISO-NE has argued convincingly that certain demand responders are taking advantage of a flaw in the tariff as it is currently written to obtain payments for a service that they are not providing. For this reason, the Commission will grant the requested waiver, and allow the tariff revisions to become effective on February 7, 2008.

26. The Commission denies the requests by EnerNOC and IECG to enjoin ISO-NE from putting into place its revised tariff provisions until after the Commission ruled on the filing. While the Commission has the authority to seek injunctive relief of violations of the FPA,[30] it will not do so here. Because ISO-NE made its filing and immediately put the tariff revisions into effect, injunctive relief would for all practical purposes have been meaningless to prevent the harm that EnerNOC and IECG feared (namely, the possibility that, if the Commission rejected the DALRP tariff revisions, it would not be possible to reconstruct the DALRP market and require refunds).[31] Further, since in this order the

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[29] *Id.* at 14.

[30] Section 314(a), 16 U.S.C. § 825m(a) (2000), provides:

> *Enjoining and restraining violations.* Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this Act, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper District Court of the United States, the Supreme Court of the District of Columbia [United States District Court for the District of Columbia], or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this Act or any rule, regulation, or order thereunder, and upon a proper showing a permanent or temporary injunction or decree or restraining order shall be granted without bond.

See California Independent System Operator Corporation, 97 FERC ¶ 61,151, at 61,660 (2001).

[31] We note in this regard that while initially ISO-NE asserted that it would be difficult to determine appropriate refunds, in a later pleading ISO-NE retreated somewhat from this position, stating that it had not stated that "refunds would be impossible to develop" and that "the ISO can assist the Commission in its fashioning of a refund remedy in the unlikely event that the Commission rejects the filing." ISO-NE February 11 answer at 11.

Commission is accepting ISO-NE's filing, EnerNOC's and IECG's requests for injunctive relief have become moot.

27. IECG argues that, by putting the revised tariff provisions into effect before the Commission accepted them, ISO-NE has violated the filed rate doctrine.[32] ISO-NE did, in fact, make its section 205 filing to revise the tariff provisions prior to implementing them, and as noted in the cases cited in footnotes 26 and 27 above, the Commission has in certain cases made tariff revisions effective with less than sixty days notice, when such actions were necessary to protect customers from the negative consequences of market dysfunction. We will, therefore, not find that ISO-NE violated the filed rate doctrine here.

Analysis

ISO-NE's Proposed Revisions

28. ISO-NE proposes to modify section III.E.2.2 so that the current minimum DALRP offer price will be indexed to the Forward Reserve Fuel Index.[33] It asserts that this approach to the minimum offer price level is just and reasonable, as it utilizes the economic equation that was implicit in the original $50/MWh minimum offer level accepted by the Commission when the DALRP was established in 2002.[34]

29. In the stakeholder process, some entities suggested that the inappropriate creation of static Customer Baselines could be addressed through changes to the existing Customer Baseline methodologies. ISO-NE notes that Customer Baseline methodologies for demand response programs are complex, and that changes that could address the

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[32] IECG February 6 protest at 10-11.

[33] The Forward Reserve Fuel Index is the index used to calculate the monthly Forward Reserve Threshold Price as defined in section III.9.6.2 of Market Rule 1. The index reflects current market conditions.

[34] As an example, the basis for the calculation as shown below for February 2008:

DALRP Minimum Offer Price set in 2002 = $50/MWh

Average Daily Spot price for Gas in NY in 2002 = $3.87/MMbtu

Dividing the Minimum Offer price by the daily spot = 12,920 MMBtu/KWh

February 2008 Fuel Price Index = $9.35/MMBtu

Multiplying the current fuel price by the implicit heat rate from above, the minimum DALRP for February 2008 would be $121/MWh. *See* transmittal letter at 15-16.

instant problem are by no means intuitive. Accordingly, ISO-NE maintains that changing the Customer Baseline methodology would not be a simple undertaking, and could consume from several months to more than a year to research, design, discuss, approve and implement such changes. ISO-NE further notes that in the stakeholder process, some parties raised concerns about the impact of the DALRP Revisions on a facility owner that had shifted production to non-DALRP hours on a permanent basis and began submitting minimum-priced DALRP offers following establishment of a Customer Baseline prior to the production shift. In response, ISO-NE notes that this behavior, by its very nature would create a static Customer Baseline and, with consistent bidding at current minimum offer price levels, would guarantee DALRP payments virtually every day. ISO-NE argues that the DALRP was not intended to provide daily compensation for such a shift: rather, the Commission recognized at the inception of the DALRP that the goal of the program was to compensate for load reductions during periods of peak demand, and a participant who received DALRP payments every day would be compensated in low demand periods as well as high demand periods. ISO-NE further states that a demand resource that reduces load consistently across a preponderance of hours - such as an energy efficiency resource – is not truly a demand response resource, and that measuring and verifying the load reductions from such resources requires an entirely different methodology from that used for demand response resources, such as those participating in the DALRP. ISO-NE states that the contribution to regional energy reduction made by such a facility would not go unrecognized or uncompensated in New England: this is the sort of activity that was the premise for identifying assets as Other Demand Resources (ODRs) and thereby providing Installed Capacity (ICAP) Transition Payments during the ICAP Transition Period.

30. ISO-NE also points out that the proposed DALRP Revisions will not affect participation in the overall Load Response Program, because the growth of the program is driven more by capacity payments than by DALRP payments. As shown in Figure 13 of the Yoshimura Testimony, enrollment in the overall Load Response Program increased substantially starting in December 2006, the beginning of the Forward Capacity Market (FCM) ICAP Transition Period.[35] Most of the increase in program participation has been in the Real-Time 30-Minute Demand Response Program and, to a lesser extent, Real-Time 2 Hour Demand Response, all of which are considered ICAP Resources that, along with ODRs, receive capacity payments at ICAP Transition Rates.[36] Further, ISO-NE states that anticipation of the first Forward Capacity Auction is boosting overall Demand Resource participation in New England wholesale markets. ISO-NE qualified about 2,500 MW of New Demand Resources for participation in the first Forward Capacity Auction, and resources clearing in that auction will be obligated to deliver their capacity

[35] Yoshimura Testimony at 30.

[36] *Id*.

by June 1, 2010.[37] Because the DALRP is scheduled to expire on May 31, 2010, along with all other Load Response Programs, these New Demand Resources would not be expecting revenue from the DALRP to help meet their Capacity Supply Obligation should they clear the first Forward Capacity Auction.

31. Also, ISO-NE notes that to participate in the DALRP, demand response assets must be registered in one of ISO-NE's Real-Time Load Response Programs. Most of the DALRP participants are also receiving ICAP Transition Payments as a Real-Time Demand Response resource: should these participants retire from the Load Response Program, they would no longer receive ICAP Transition Payments. ISO-NE explains that given the availability of such payments, it is highly unlikely that an entity would withdraw from the Load Response Program altogether, just because its payments from the optional add-on of the DALRP may be reduced.[38] ISO-NE reiterates that real reductions will continue to receive compensation in the DALRP at periods when LMPs are high and the benefits to overall load of DALRP reductions are meaningful.

32. Last, ISO-NE states that based on discussions with stakeholders, it agrees that it would be appropriate to continue to explore whether there are additional or improved measures (beyond those offered in the instant filing) that could be utilized to address, on a longer-term basis, the issue of strategic behavior in the DALRP. Thus, ISO-NE notes that it has committed to study this matter with a priority and in a time frame that will support NEPOOL Participants Committee consideration of any recommended additions or improvements to the ISO-NE Tariff modifications at its meeting on April 4, 2008. ISO-NE states that by April 15, 2008, it will provide the Commission with either an informational report regarding its findings or additional tariff changes resulting from the stakeholder process.

Protests and Comments

Comments in Support of the Proposed Changes

33. In comments supporting the adoption of ISO-NE's proposed changes, NEPOOL states that ISO-NE's proposal restores the minimum offer price to levels that were determined to be just and reasonable by the Commission, providing payments for real-time load reductions in response to relatively high Day-Ahead Energy Market prices.

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[37] *See* ISO-NE's "Informational Filing for Qualification in the Forward Capacity Market" at 6 (Docket No. ER08-190-000, filed November 6 and November 14, 2007). The informational filing was accepted by Commission order issued January 11, 2008. *See ISO New England Inc*., 122 FERC ¶ 61,018 (2008).

[38] Yoshimura Testimony at 31.

NEPOOL notes that its support was conditioned with two commitments from ISO-NE.[39] First, that ISO-NE continue to explore alternative revisions over the next two months and, second, that it evaluate DALRP objectives for any longer term changes needed. NEPOOL states that ISO-NE has committed to complete its first commitment in time for NEPOOL Participants Committee consideration at its April 4, 2008 meeting, with the second commitment taking place over the next several months. The NRG Companies, BG Entities, and the CT DPUC similarly support ISO-NE's proposed modification, with the NRG Companies stating that the proposal restores the program to its original intent. These parties all also support ISO-NE's commitment to continue to discuss the design and operation of the DALRP in the stakeholder process. Noting the scheduled termination date of May 31, 2010 for the DALRP, the NRG Companies would support earlier termination of the DALRP if the region's stakeholders and ISO-NE can devise a means to better integrate these resources into the energy markets. The CT DPUC believes there may be merit in altering the current customer baseline methodology.

Adverse Comments

34. While acknowledging that there may be a problem associated with the current baseline methodology, IECG and EnerNOC protest ISO-NE's proposed solution of indexing the Minimum Offer Price. EnerNOC argues that if the Commission does not reject the proposed tariff changes outright, then it should set the proposed revisions for hearing, suspending the hearing pending resolution of the stakeholder process. In addition, EnerNOC maintains that DALRP participants provide substantial net benefits at heat rate thresholds (and thus prices) below ISO-NE's proposed threshold. EnerNOC argues that the proposed solution would eliminate those benefits, drastically reducing the number of days that a demand response asset is able to participate in the market. EnerNOC contends that this reduction in demand response is contrary to the Commission's policy to permit demand resources to participate on an equal basis with generation in the markets. Further, EnerNOC argues that ISO-NE has erred in basing its revised minimum offer price on gas pricing data from 2002 (when the DALRP was proposed), given that the DALRP was not implemented until 2005; thus, EnerNOC states, ISO-NE has not shown that the use of 2002 pricing data is just and reasonable.

35. EnerNOC and IECG are concerned that ISO-NE's proposed stakeholder process may not be a collaborative process but instead will be a one-time chance to submit proposals that will be unilaterally reviewed by ISO-NE. EnerNOC contends that a "narrowly tailored solution" to address the customer baseline methodology under the DALRP would remedy the problems identified by ISO-NE. EnerNOC also maintains that ISO-NE's "drastic and overbroad solution" would prevent viable demand response from participating in the energy market.

[39] As noted previously, NEPOOL states that ISO-NE's proposed DALRP modifications were supported by an 82.04 percent Participants Committee Vote.

36. IECG contests ISO-NE's arguments concerning the role of demand response in the energy market and further argues that it is time for the Commission to mandate full integration of demand side resources into ISO-NE's energy market as of January 1, 2009. IECG argues that ISO-NE's proposal is contrary to sound public policy and is founded on a misunderstanding of how demand response works. Specifically, IECG argues (in contrast to ISO-NE) that long-term changes in demand profiles (for example, shifting production to off-peak hours) is reflective of demand response and should be compensated as such in the energy market, not just in the capacity market. Yet, according to IECG, ISO-NE has filed rate schedules that shut load resources out of the market in most hours and potentially exclude numerous load resources that provide genuine energy reductions.[40] IECG points to cases in which, in its view, the Commission has required ISO-NE to integrate load response into its markets, but ISO-NE has sought to avoid doing so.[41] IECG argues that where load reduction in response to price can be verified, ISO-NE should be required to accept any demand resource bid that is lower than a supply side bid.

37. In further support of its arguments, IECG offers affidavits from Maine industrial consumers that have modified their production on a long-term basis to operate off-peak and participate in the DALRP, arguing that the revised minimum offer price mechanism will prevent their continued participation. IECG states that in contrast to every capacity market design that the Commission has accepted, ISO-NE's proposal disallows the collection of real time energy payments on the grounds that these participants are eligible to receive capacity payments. Thus, IECG contends, ISO-NE should be directed to report to the Commission in April with a methodology for allowing for the full integration of demand response into the energy markets.

38. IECG also contests ISO-NE's offered argument about the economic inefficiency of load being paid for reductions when marginal supply costs are less than the customer's opportunity cost of foregone consumption. IECG contends that this argument is flawed since when a customer shifts load off peak, they do not forego production or sales. Instead, the customer makes an investment to operate off peak, with costs offset by

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[40] IECG February 15 protest at 30.

[41] IECG points to prior Commission orders, stating that after the Commission directed ISO-NE to develop a Day Ahead Load Response Program in December, 2002, in 2003 ISO-NE sought relief from the Commission's deadline, and that the Commission rejected the program filed by ISO-NE in 2004 because that program did not adequately address integration of load resources (*citing ISO New England Inc.*, 109 FERC ¶ 61,314, at P 4, 24 (2004)). IECG further states that ISO-NE again filed a program that did not integrate load resources, but committed to file an integrated program by 2007 (*citing New England Power Pool and ISO New England Inc.*, 111 FERC ¶ 61,064, at P12, 21, Ordering Paragraph B (April 18, 2005)). *See* IECG February 15 protest at 29.

compensation received through the DALRP. IECG further disputes ISO-NE's argument that one MW of demand response at high prices (where the supply curve is steep) is worth more than one MW of demand response at low prices (where the curve is relatively flat). IECG argues that ISO-NE fails to understand the critical points in its load curve where savings can be achieved. For example, IECG maintains that the supply curve in New England is highly discontinuous, with steep increases where there are changes in generation technology and that these steps represent an opportunity for demand response to reduce the clearing price. Thus, IECG contends that limiting demand response opportunities in the energy market to "flip the switch" dispatch responses damages the competitiveness of the market.

39. Addressing ISO-NE's revision of the Minimum Offer Price from $50/MWh to an indexed level based on the dramatic increase in fuel costs, IECG maintains that from a consumer point of view, $50/MWh is still a high price. Thus, IECG argues that this price increase represents a fundamental change in the energy market that, in contrast to ISO-NE's proposal, makes the participation of demand resources even more important. IECG maintains that the market behavior in question cannot raise or manipulate Day Ahead clearing prices, is not an exercise of market power, and does not threaten reliability in the short term and is not a direct threat to the overall competitiveness of the market. Further, IECG argues that a customer's reason for adopting a Demand Response alternative is irrelevant, and that the only relevant issue is whether paying the customer to do so decreases the overall cost of service.

40. Last, IECG states that ISO-NE ignored IECG's alternative proposal, which would not cause comparable harm to society at large and demand response providers. IECG states that its proposal would have required a freeze on payments to all participants in the DALRP who - as of February 1, 2008 - have had a static Customer Baseline for over two months, so that no change would be made in such participants' Customer Baselines as they existed on February 1, 2008. The freeze would be removed only under "voluntary action" in consultation with ISO-NE to reset the Customer Baseline. Further, under IECG's proposal, Customer Baselines would be reset subsequently every six months on a voluntary basis for assets that at that time had a two-month static Customer Baseline, with such reset to be "monitored" by ISO-NE. Protocols for verifying customer baselines would be developed that would grant ISO-NE some discretion to tailor compliance to a specific demand resource methodology.[42] IECG argues that its proposal should be adopted pending full integration of demand response into the ISO-NE energy markets.

[42] During the stakeholder process, a motion to amend ISO-NE's proposal reflecting this approach failed to pass in the Participants Committee, with a vote of 27.99 percent in support. Transmittal letter at 20 n.70.

Answers

41. In its February 11 answer, ISO-NE states that an entity making permanent demand shifts should not be compensated through the DALRP. ISO-NE notes that participants in the DALRP must be in the ISO-NE Real-Time Demand Response Program. ISO-NE points out that, if it were to call upon a resource that has already made a permanent load shift to off-peak to reduce load under a capacity shortage event, the load reduction that the system needs in real-time has already been removed from the system: thus, the system will not receive the relief it had been expecting from this customer. ISO-NE argues that this would be especially true in a situation in which the Customer Baseline has been frozen to higher, pre-permanent load reduction levels through the use of strategic bidding in the DALRP. Thus, ISO-NE argues that participation by such entities would endanger system reliability because those entities are not capable of delivering real-time relief in the quantity expected by the system operator at the time it is needed. In addition, ISO-NE argues that if a customer chooses to permanently reduce or shift its load, it does not imply that its Customer Baseline, which is used to determine the demand reduction quantity, ought to be frozen at a particular level indefinitely, because compensation should not be made for load that would not have been consumed in the first place.

42. ISO-NE also notes that permanent demand shifts (such as those described by the offered affidavits from IECG) do not go uncompensated in New England. ISO-NE states that energy efficiency and load management resources can receive ICAP Transition Payments as ODRs.[43] ISO-NE further explains that characterizing and registering a resource into the correct Demand Response category is essential for reliable and efficient system and market operations.

43. Addressing general arguments about the roles for Demand Response in New England, ISO-NE points to the fact that there are five recognized categories of Demand Response,[44] which allow demand resources to participate in New England markets. Further, ISO-NE also highlights its commitment to explore participant behavior in the DALRP on a long-term basis, including stakeholder discussions and a subsequent filing with the Commission by April 15, 2008.

44. In response to IECG's proposal to freeze customer baselines pending consultation with ISO-NE, ISO-NE argues that this proposal would not address the concerns of ISO-NE or other stakeholders regarding the strategic behavior by some DALRP participants.

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[43] ISO-NE Tariff § III.8.3.6.2.

[44] Those programs are the 30-Minute, 2-Hour, Profiled Response, and Price Response Programs and the DALRP. A sixth program, the Demand Response Reserve Pilot Program, is in development for resources of less than 5 MW.

ISO-NE contends that the proposal is too vague to constitute tariff language – it does not specify what sort of "voluntary" action would qualify for a lifting of the "freeze" on DALRP payments. Further, ISO-NE states that IECG's alternative contemplates awarding vague and impermissibly broad discretion on ISO-NE to determine whether a DALRP participant would continue to receive payments from the program. Finally, ISO-NE argues that, absent an adjustment to the fixed $50/MWh minimum offer price, IECG's proposed six-month cycle would facilitate the ability of a DALRP participant to exaggerate an asset's Customer Baseline and then lock it in for the next six months.

45. In its February 19 answer, IECG argues that ISO-NE's answer confirms its view that absent Commission direction, ISO-NE has no intention of allowing Demand Response participation in the energy markets on a level comparable to generation resources. Thus, IECG states, the stakeholder process will not genuinely provide a forum to consider comparable treatment of demand response resources.[45]

46. ISO-NE's March 3 answer to the IEGC's February 15 supplemental protest notes that ISO-NE is fully committed to a vibrant and increasing role for demand response, and that IECG's assertions to the contrary are not relevant to the question of whether the proposed revisions to the DALRP are just and reasonable. ISO-NE stresses that the demand resource participation in ISO-NE's first Forward Capacity Auction (FCA) held February 2008, has been significant: twice as many new demand resources as new generating resources cleared in the FCA. ISO-NE also suggests that the 2,065 MW of demand resources that now participate in ISO-NE's wholesale market is further evidence of its commitment.

47. ISO-NE further asserts that, once it has filed tariff provisions under section 205, the Commission's role in reviewing that filing is limited to accepting the filing if the Commission considers it just and reasonable, even if the Commission considers other possible programs to be superior (given that there can be more than one just and reasonable choice). ISO-NE states that protesters are attempting to hijack this section 205 proceeding by, rather than simply arguing that ISO-NE's proposal is not just and reasonable, instead seeking to use ISO-NE's filing as an "open season" to redesign New England's demand response programs. ISO-NE states that IECG's and EnerNOC's arguments that an entirely different daily compensation program should be substituted for the DALRP program as revised by ISO-NE, or that the Commission must compel ISO-NE to design such a program, is irrelevant to the question of whether ISO-NE's revisions are just and reasonable. According to ISO-NE, if protesters wish to propose their own day-ahead demand response program, they must do so by filing a

[45] In its answer, NEPOOL addresses IECG's and EnerNOC's concerns over the subsequent stakeholder process by noting its independence from ISO-NE and its commitment to ensure that the stakeholder process will be meaningful.

complaint under section 206, in which case they will bear the burden of proving that ISO-NE's DALRP is unjust and unreasonable.

48. IECG's March 7 answer reiterates its prior arguments, and also addresses the parameters of the Commission's review of a just and reasonable rate design. With regard to ISO-NE's argument that the IECG alternative is not relevant to the Commission's review of ISO-NE's proposal, IECG states that because it has demonstrated that ISO-NE's proposal is unjust and unreasonable, then under section 205(e) the Commission is free to substitute any alternative necessary to achieve a just and reasonable result.

Commission Ruling

49. The purpose of the DALRP is to offer participants in the Real-Time Load Response Program the opportunity to offer load reductions in response to day-ahead LMPs. As discussed in the order in which the Commission approved the DALRP,[46] offers made into the DALRP are not integrated into the determination of the day-ahead LMP. Instead, the premise of the program is that cleared DALRP load reductions will reduce real-time demand, and thus will reduce real-time LMPs. Payments made to DALRP participants are ultimately funded by all electricity customers in New England, on the basis that all customers benefit from demand response behavior that results in reductions in real-time electricity demand that lower real-time LMPs. Day-ahead payments are based on the difference between a demand response asset's Customer Baseline and the asset's actual load during the hours in which the asset's DALRP load reduction offer was accepted, on the basis that the dynamic Customer Baseline will accurately reflect the customer's reduction.

50. In its filing to revise the Minimum Offer Price in the DALRP, ISO-NE offers evidence that certain DALRP participants are intentionally establishing a static Customer Baseline in order to receive energy and capacity payments "even though the customer is taking no action to reduce its usual consumption levels."[47] Many of these participants are offering the minimum load reduction at the Minimum Offer Price, in order to ensure that their offers will clear in the DALRP, and that they will maintain a static Customer Baseline (since the Customer Baseline is not adjusted on days where day-ahead offers are accepted).[48] As demonstrated by IECG, many industrial customers have even shifted their production work to off-peak hours. This enables such customers to maintain their

[46] *New England Power Pool*, 111 FERC ¶ 61,064 (2005).

[47] Transmittal letter at 10.

[48] ISO-NE states that the majority of the Customer Baselines of assets in the DALRP are static, with four assets having a static baseline for at least 180 days. Transmittal letter at 11.

original Customer Baseline (that was derived during peak DALRP hours), but at the same time to offer demand reduction into the DALRP that is not genuinely available during those hours. Moreover, based on ISO-NE's evidence, other participants have actively inflated their Customer Baseline by either turning off their behind-the-meter generation during the initial metering period while the Customer Baseline is being established, or (for an asset with a relatively higher summer load profile) by withdrawing from the program and reenrolling in order to reestablish their Customer Baseline during the higher load summer season.[49] It is clear that by the sudden growth in DALRP participation and resulting payouts that this problem is expanding rapidly.

51. The relatively low Minimum Offer Price (as compared to current LMPs in New England) is the driver of static Customer Baselines and thus allows participants to receive payments for these daily phantom load reductions. Therefore, we must first examine the purpose of setting a minimum offer price. IECG and EnerNOC implicitly question the basis for the Minimum Offer Price, arguing that load response should be able to compete with supply at all prices in the energy market and that demand response should be fully integrated into the clearing price of the Day-Ahead Market (DAM). Addressing this point in its filing, ISO-NE points to two Commission orders where the fundamental basis for the Minimum Offer Price was addressed. Discussing the DALRP in the first order, the Commission noted:

> The program is intended to encourage reduced consumption during peak periods when demand is high relative to supply ... and energy prices rise. *It is reasonable to limit the additional payment incentive for reducing demand to periods when demand is high relative to supply, and not to offer the incentive when supply is ample relative to demand.* Establishing a suitable bid floor or minimum triggering price, as proposed by ISO-NE, is one way to target the incentives to these tight-supply periods.[50]

52. In a subsequent challenge to the Minimum Offer Price, the Commission noted:

> The Commission rejects NXEGEN's request to remove the $50/MWh floor. As the Commission has stated in previous [New York Independent System Operator (NYISO)] and ISO-NE orders, the $50/MWh floor "will encourage reduced

[49] With respect to ISO-NE's allegations, we note that the Commission's Office of Enforcement began a non-public investigation in February 2008 into whether any participants in the DALRP have violated the Commission's rules.

[50] *New England Power Pool*, 101 FERC ¶ 61,344, at P 44 (2002), emphasis added.

> consumption during peak periods when demand is high relative to supply and when energy prices rise. We also believe that it is reasonable to limit payment, as an incentive for reducing demand, when supply is ample, relative to demand."[51]

Thus, contrary to IECG's and EnerNOC's arguments, our approval of the Minimum Offer Price was based on our view that in the DALRP, demand response was desirable, and should be financially supported, during peak periods when demand was high relative to supply, i.e., not at all levels of supply and demand.[52]

53. As ISO-NE notes, when the $50/MWh Minimum Offer Price was proposed in 2002, natural gas prices were less than $4.00/MMBtu and wholesale energy prices exceeded $50/MWh less than 12 percent of the time. Thus, the $50/MWh Minimum Offer Price was consistent with DALRP participation during relatively high price hours to improve market efficiency, and at that time, participation in this program was relatively modest. But since the creation of the program, wholesale energy prices have increased dramatically in New England: ISO-NE states that natural gas prices are now typically in the range of $7.00 to $10.00/MMBtu and day-ahead LMPs exceed $50/MWh approximately 84 percent of the time.[53] We thus believe that it is this fact and the opportunities for payments that it presents that have driven the rapid increase in DALRP participation and encouraged participants to create the inflated baselines that have enabled the corresponding payments.

54. As discussed above, the Commission did not intend DALRP participants to receive daily payments for normal consumption. Yet, ISO-NE contends, under the current rules, a participant offering to reduce load during eligible program hours at $50/MWh would have cleared *every* eligible day (and retained a static baseline which drives payments) since January 1, 2007. Further, without a relatively high Minimum Offer Price, a participant that is actually out of service could be paid under the DALRP in

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[51] *New England Power Pool*, 105 FERC ¶ 61,211, at P 21 (2003).

[52] At the time that it proposed a Standard Market Design for New England, ISO-NE offered an example to support the use of a Minimum Offer Price in the DALRP, to avoid paying for apparent, rather than real, load reductions, stating that, "[a] minimum bid of $50.00 will be required to assure that demand resources that are scheduled out of service (e.g., for a facility shutdown) will not be able to receive credit and payment for a reduction." Transmittal letter of New England Power Pool and ISO New England Inc.; Docket No. ER02-2330-000, Proposed Standard Market Design for New England, Attachment 2, at 36 (July 13, 2002).

[53] Yoshimura testimony at 11.

all program hours for demand response that it is not providing.[54] Neither IECG nor EnerNOC in their protests have addressed concerns over demand response payments for such scheduled outages, or Commission precedent explaining the purpose of the Minimum Offer Price of the DALRP.

55. Further, we note that the Commission explicitly approved the current format whereby offers in the DALRP are not integrated into the clearing price of the Day-Ahead Market (DAM).[55] Our order approving the current design of the DALRP noted that at the time, the costs associated with implementation of integrated clearing of demand response in the DAM outweighed the benefits.[56] Thus, we stated that integration of all DALRP offers into the clearing price of the DAM should be delayed pending implementation of Asset Related Demand as a new resource class in planned upgrades to the ancillary services market.[57] IECG appears to argue that the Commission's historical desire to have DALRP offers integrated into the calculation of the DAM clearing price is equivalent to an intent to fully integrate demand response at all price levels, so that demand offers and supply offers should be treated the same at all price points, and argues that the Commission should use the opportunity presented by the instant filing to mandate that ISO-NE fully integrate demand side resources into ISO-NE's energy market as of January 1, 2009.

56. While it is true that the Commission has previously sought integration of the DALRP into the determination of the DAM clearing price, that does not mean that a fully integrated DALRP would not still retain a Minimum Offer Price. In fact, we note that NYISO has a Commission-approved Minimum Offer Price for its day-ahead load response program, despite the fact that offers in this program *are* integrated into the determination of the DAM clearing price.[58] We maintain that this filing is not the proper

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[54] ISO-NE offers evidence of a factory that was shut down between Christmas Eve and New Year's Eve in 2007, but that offered $50/MWh into the DALRP for each non-holiday weekday during that period. Since a $50 Minimum Offer Price in this market is, in today's market, realistically equivalent to not having a Minimum Offer Price, these offers were accepted and the participant was paid for providing "demand response" during a scheduled outage period. *Id.* at 27.

[55] *New England Power Pool*, 111 FERC ¶ 61,064 (2005).

[56] *Id.* P 21-22.

[57] Asset Related Demand refers to larger assets (5 MW or greater) that can offer into the forward markets.

[58] *See* NYISO Tariff original Volume No.2, Third Revised Sheet No. 95A ("A zonal floor bid price of $75/MW hour is applicable to all Day-Ahead Demand Response Resources that bid into the Day-Ahead Energy market").

forum for IECG's alternative suggestion that ISO-NE be required to redesign the energy market to incorporate demand response on an equal footing with generation. ISO-NE has demonstrated that its proposed revisions to the DALRP rules are just and reasonable. Since we find that the revisions ISO-NE proposes here are just and reasonable, the broad redesign suggested by IECG is not necessary to render prices and payments in the DALRP just and reasonable.

57. In support of a Minimum Offer Price construct, ISO-NE assembles general economic arguments about the societal harm of paying for demand response when marginal supply costs are less than the customer's opportunity cost of foregone consumption, on the basis that such payments are inefficient from a societal benefits point of view. IECG and EnerNOC contest those arguments, and IECG views ISO-NE's proposed solution of indexing the Minimum Offer Price as revealing a fundamental difference between itself and ISO-NE on the legitimacy of Demand Response in the energy market. Moreover, IECG argues that in implementing its price indexing proposal, ISO-NE has restricted the ability of demand response to participate in the energy market. According to IECG, given the discontinuity of the supply curve in New England, demand response at all price levels can have significant impacts on the energy clearing price.

58. The Commission finds, however, that the arguments put forth by IECG and EnerNOC fail to address the current situation in the DALRP. Specifically, these arguments ignore the fact that a Commission-approved Minimum Offer Price construct *already exists* for this program. Further, participants that have moved load to off-peak (and who, according to IECG, are providing demand response) are *not available* to provide load response in either the DALRP or real time load response program. As noted above, the DALRP hours are non-holiday weekdays from 7 AM to 6 PM. Because participants in the DALRP are required to also participate in the real-time load response program, it is not clear what these participants are being paid for, nor what demand response they could provide when called upon, since they are not operating during these hours.[59] Besides raising payment issues (in both the energy and capacity market), this also poses a threat to system reliability since the system operators will assume that the Customer Baseline reflects a "normal" non-load response day.

59. Even given ISO-NE's assertions of manipulation in this market, IECG argues not only that the alleged behavior is consistent with the market design, but also that such behavior should be compensated under at least the status quo, if not at all given price levels. We disagree: rather, in our view, ISO-NE's proposal properly returns the DALRP

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[59] This argument is magnified for those participants who have intentionally inflated their Customer Baseline during the initial measurement period, increasing the disparity between the basis for their DALRP payments and their actual available demand response.

to its initial purpose – namely, to provide benefit to the system at times of high LMPs – while protecting customers from being charged for services that are not in fact provided. ISO-NE's proposal continues to fulfill this policy determination; it merely adjusts the Minimum Offer Price to reflect current marginal fuel prices.

60. IECG argues that the behavior in question here cannot raise or manipulate Day Ahead prices, is not an exercise of market power, and does not threaten reliability in the short term, and therefore, is not a direct threat to the overall competitiveness of the market.[60] Further, IECG states that expedited implementation of the ISO-NE proposal would undermine public policy favoring Demand Response.[61] Last, IECG argues that "it is irrelevant how or why a customer agrees to adopt a Demand Response alternative in response to a price. What is important is only whether paying them to do so decreases the overall Cost of Service."[62] While IECG is correct that the participants cannot affect day-ahead LMPs, the current tariff improperly allows customers to be charged for services that are not in fact being provided. We reiterate that ISO-NE has demonstrated that the payments associated with this program have grown from $1.74 million in 2006 to $16.81 million in 2007, with more than 75 percent of the cleared offers stemming from customers with a static Customer Baseline. In these circumstances, we find that the retention of the current structure for this market undermines any public policy supporting demand response far more than the expedited implementation of ISO-NE's proposed solution.

61. Our finding here does not constitute a judgment on whether shifting production load to off-peak should be considered demand response on a theoretical level. Our dispute with IECG's position is restricted to whether, in the construct of ISO-NE's DALRP, such a shift should be compensated as demand response, especially when those reductions in demand would in reality be unavailable during DALRP program hours, and when resources in the DALRP are required to be part of a real-time load response program.

62. Moreover, IECG does not dispute ISO-NE's contention that the Other Demand Resource (ODR) capacity program, which recognizes Energy Efficiency, Load Management, and Distributed Generation resources that permanently reduce or shift load, allows resources that have shifted their production to off-peak to receive payments in the

[60] IECG February 15 protest at 9.

[61] IECG February 6 protest at 8-10.

[62] IECG February 15 protest at 22.

capacity market during the ICAP Transition Period.[63] ISO-NE notes that 365 MW of capacity (out of 2065 MW in ISO-NE's current demand response programs) have registered under the ODR capacity program.[64] IECG seeks to have DALRP participants to be paid in the energy market during DALRP hours for on-peak demand response that its off-peak participants are not able to provide, but offers no basis for why payments under the ODR program are insufficient for these resources. We note that under ISO-NE's proposed DALRP revision, to the extent that these participants are able to provide actual real-time or day-ahead load response reflective of the indexed minimum offer price, they will receive energy payments.

63. We find ISO-NE's proposed changes to this program to be a just and reasonable solution, because they will more accurately tie program payments to actual demand response. Besides protecting customers from being charged in both the energy and capacity markets for services that are not in fact provided, ISO-NE's proposal will also address operational concerns, as updated Customer Baselines should more accurately reflect actual available load response.

64. Further, we note that the stakeholder process provides a forum for EnerNOC and IECG to address their concerns with the long-term prospects of ISO-NE's proposal. Indeed, ISO- NE has indicated that it continues to review this issue and it has committed to make a filing with this Commission by April 15, 2008 that will either inform the Commission regarding ISO-NE's findings, or will propose additional ISO Tariff changes resulting from the ongoing stakeholder process.

65. Under the FPA, the issue before the Commission now is whether the proposed tariff changes are just and reasonable and not whether the proposal is more or less reasonable than other alternatives.[65] We find that the proposal is just and reasonable. Thus, we find the alternative proposals to address the identified problem in the DALRP offered by EnerNOC and IECG to be outside the scope of our review here. We also find no merit in EnerNOC's argument that ISO-NE should use 2005 fuel prices to calculate the implicit heat rate (rather than 2002) simply because the DALRP program was not actually implemented until 2005, since ISO-NE's proposal to use indexed fuel prices to

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[63] ISO-NE maintains that measuring and verifying the load reductions from such resources requires an entirely different methodology from that used for demand response resources, such as those participating in the DALRP. Transmittal letter at 22.

[64] ISO-NE March 3 answer at 13.

[65] *ISO New England Inc.*, 114 FERC ¶ 61,315 at P 33 & n.35 (2005), *citing Pub. Serv. Co. of New Mexico v. FERC*, 832 F.2d 1201, 1211 (10th Cir. 1987) and *Cities of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984).

derive an implicit heat rate is consistent with, and implements, the program's originally-intended design.

The Commission orders:

(A) The revisions are hereby accepted and made effective February 7, 2008, as requested.

(B) Waiver of the requirement that ISO-NE notify parties 60 days before implementing this rate change is granted, as discussed above.

By the Commission. Commissioner Kelly concurring with a separate statement to be issued at a later date.
Commissioner Wellinghoff concurring in part and dissenting in part with a separate statement attached.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ISO New England Inc. Docket No. ER08-538-000

(Issued April 4, 2008)

WELLINGHOFF, Commissioner, *concurring in part and dissenting in part*:

In today's order, the Commission accepts a proposal from ISO New England Inc. (ISO-NE) to increase the minimum price at which a demand response provider may offer to the Day-Ahead Load Response Program (DALRP) for load reductions the next day.

This proposal arises from problems recently identified by ISO-NE that can result in certain customer baselines not being updated when their normal consumption varies due to changes in weather, season, operation schedules, and other factors that may cause a customer's load to vary from day to day and month to month. A customer's baseline is the estimate of what the customer's normal daily consumption pattern would have been without any demand response action. Accurate representation of the customer's normal load is necessary to measure and verify that the load reductions indeed occur, so that demand response providers get paid for their service and New England consumers pay only for the service provided.

According to ISO-NE, market participants offering at the current minimum $50/MWh price are clearing virtually every weekday. Because calculation of the normal consumption baseline excludes days on which a market participant is cleared, this results in a static customer baseline, that is, a customer baseline that does not change over time. ISO-NE provides the example of a participant with a load profile that is typically higher in the summer than the winter. If this customer's baseline is established in the higher usage summer months, ISO-NE is concerned that the static baseline will produce load reductions in the non-summer periods even though the customer is taking no action to reduce its usual consumption levels. ISO-NE reports that almost 60 percent of the assets clearing in the DALRP had a static baseline. However, we are provided no additional evidence regarding the extent to which customers have loads that vary significantly, such as between summer and winter, to be able assess whether or not the problem is widespread. Indeed, the unvarying load profiles may in fact be an

accurate representation of a customer's normal consumption. In such cases, the customers have provided real, verifiable load reductions.

The solution we approve today does not address the problem directly, nor is it intended to do so. My reading of the Commission's previous orders relating to the DALRP does not indicate an intention for the minimum offer price to be the primary tool for validating the measurement and verification methodology. Instead, the Commission has reaffirmed several times that the stated purpose for the minimum offer price is to target demand reductions to periods when demand is high relative to supply.[1]

However, it is important to recognize that ISO-NE's proposal leaves unresolved the fundamental problem as to how an individual customer's baseline load should be determined if seasonal variations and operations schedule changes occur. Further, raising the minimum offer price affects all demand response providers including those who have no such variations and for whom the non-varying baselines are accurate representations of their load profile, and who could provide cost-effective demand reductions at prices below the index. By excluding such legitimate market participants we lessen the market benefits that could accrue to all New England consumers.

ISO-NE's testimony indicates that its stakeholders also see a need for longer term solutions.[2] I agree. There will be a need for accurate baselines for measuring performance in future programs that fully integrate demand resources into ISO-NE's markets. A more precise tool is needed – a customer baseline methodology that accounts directly for seasonal shifts in customer load and for scheduled demand changes such as vacations, maintenance outages, and plant shutdowns. In that regard, ISO-NE has pledged to continue to explore additional or improved measures that could be utilized to address, on a longer-term basis, the issue of strategic behavior in the DALRP and to report to the Commission on it progress by April 15. However, a solution is needed sooner rather than later.

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[1] *New England Power Pool*, 100 FERC ¶ 61,287 at 117,123 (2002); *New England Power Pool*, 101 FERC ¶ 61,344 at 44 (2002).

[2] Testimony of Henry Y.Yoshimura, ISO-NE's Manager of Demand Resources, at page 37, filed as Attachment 1 to ISO-NE's transmittal letter in this filing..

I respectfully dissent in part because the job is not finished. I would have directed ISO-NE to expeditiously address with its stakeholders the fundamental issues of the existing customer baseline methodology for assessing baselines of demand response participants, and to report to the Commission an action plan for resolution in its April 15 report.

In addition, ISO-NE has presented information that may indicate that some customers are intentionally inflating their baselines. Whether a supplier or demand response provider, market participants that do not play by the rules harm a market and deny consumers the benefits of competition. Our Office of Enforcement is investigating this matter. At the conclusion of the investigation, the Commission will take all appropriate action.

For these reasons, I respectfully concur in part and dissent in part.

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Jon Wellinghoff
Commissioner