

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

Demand Response Compensation in Organized Wholesale Energy Markets))))	Docket No. RM10-17-000
---	------------------	-------------------------------

**TECHNICAL CONFERENCE COMMENTS OF JOHN J. KEENE JR.
ON BEHALF OF THE NEW ENGLAND CONFERENCE OF PUBLIC UTILITIES
COMMISSIONERS**

September 13, 2010

The New England Conference of Public Utilities Commissioners (“NECPUC”) appreciates this opportunity to participate in this Technical Conference on Demand Response Compensation in Organized Wholesale Energy Markets. NECPUC endorses the use of a ‘net benefits’ test for determining when to compensate demand response providers and offers four recommendations for you to consider in the final rule. NECPUC recommends that the Commission: (1) require use of a ‘net benefits’ test, (2) refrain from prescribing a standard ‘net benefits’ test, (3) provide clear guidance on the objectives such tests should seek to balance, and (4) require each region to develop its own test consistent with those objectives.

Need for ‘net benefits’ test

The Commission proposes to compensate demand response at full locational marginal price (“LMP”) in all hours. NECPUC agrees with compensating demand response at full LMP for the reasons stated in our initial comments, but allowing such compensation ‘in all hours’ may unreasonably increase costs to consumers in certain circumstances. Procuring demand resources as supply at full LMP results in fewer billing units over which to recover

costs. This is referred to as the “missing money” problem. If the benefits resulting from decreased prices are outweighed by the “missing money,” the additional resulting costs to consumers may be unjust and unreasonable. Such an outcome may be inconsistent with the concept of least cost dispatch inherent in standard market design. Thus, it is imperative that the benefits resulting from decreased prices outweigh the “missing money.”

Whether dispatching demand response results in net benefits depends upon the characteristics of the supply offers in the bid stack. A net benefits test should only allow demand response to participate or be dispatched when these benefits are most likely to be positive. As long as the per unit increase in costs is outweighed by the overall decrease in prices resulting from displacing higher-cost marginal resources, compensating demand response at full market price will benefit consumers, make the energy market more competitive, and enhance the reliability of the system. Accordingly, using a ‘net benefits’ test to determine where price reduction is likely to be greater than the cost to procure, is an appropriate means to integrate greater levels of demand response into the wholesale energy market while balancing the interests of consumers.

The Commission need not determine a net benefits test in its final rule

As noted in our initial comments, NECPUC recommends use of dynamically-adjusted minimum offer price model like that currently used in New England’s Day Ahead Load Response Program (DALRP). That said, the Commission need not and should not prescribe a standard net benefits test in its final rule. Rather, the Commission can and should allow each region to develop its own mechanism for determining net benefits.

Other regions have a different supply mix and may have different resource types on the margin. The frequency at which a particular resource type is on the margin also varies across regions. NECPUC's preferred model essentially establishes a proxy for the marginal unit, and accordingly, may be able to be adapted to circumstances in other regions. However, due to unique regional characteristics this model may not be as well suited in other regions, or other region may simply prefer another model. Regional stakeholder forums are better suited for assessing regional characteristics and determining which mechanisms are most appropriate for each region. Accordingly, NECPUC recommends that the Commission not prescribe a standard net benefits test and allow each region to develop its own mechanism to be reviewed in a compliance filing.

Principles for establishing net benefits test

Although, we do not recommend proscribing a standard net benefits test, the Commission should provide guidance for establishing such a test. To that end, the Commission should consider the objectives of a net benefits test that should guide formation of regional tests to ensure that the chosen mechanisms achieve the desired outcomes. For the reasons described earlier, any net benefits test should first and foremost ensure that integration of demand response provides all market customers with net benefits. However, net benefits tests should also consider the following objectives:

- Mitigation price formation concerns;
- Protection of the integrity of baselines and other methods of measuring and verifying load curtailment; and
- Balance wholesale and retail demand response.

Mitigating Price Formation Concerns

Price formation concerns relate to behavior that may theoretically increase total production costs to society for procuring electricity. Such concerns, which have been raised by some on this panel, relate to potentially inefficient price signals when an entity that responds to high prices by curtailing demand receives two income streams: (1) savings from curtailment and (2) compensation from the energy market. In theory, this may provide an incentive for some consumers to either under-consume or utilize distributed resources that are more expensive than central station resources.

NECPUC has stated that demand resources should be economically justified from the perspective of the wholesale market, without concern for broader societal impacts such as customer bill savings from curtailment. Demand response resources should not be denied a payment equal to the full LMP on the basis of price formation concerns.

However, price formation concerns should not be entirely ignored either. Use of a ‘net benefits’ test will limit the circumstances under which demand response may participate or be dispatched, thereby mitigating, at least in part, concerns over price formation.

Protect the Integrity of Measurement and Verification

Another objective for requiring a net benefits test is to protect the integrity of measurement and verification mechanisms. Rather than requiring customers to purchase energy in advance, which in our view, is simply the equivalent of compensating demand response at less than full LMP, the customer’s expected purchases form a baseline from which their curtailment is to be measured and evaluated. If a customer is called upon to provide demand response too frequently, identifying their baseline usage patterns becomes increasingly

difficult to measure and verify with precision. Accordingly, a ‘net benefits’ test that limits participation or dispatch to a limited number of hours will minimize potential distortion of consumption baselines and preserve the integrity of measurement and verification.

Impact on retail demand response

The final objective, which NECPUC recommends be considered, is the impact that participation in wholesale markets may have on retail level demand response including dynamic and real-time pricing. As smart grid technologies and pilot dynamic pricing programs are rolled out, competition from the wholesale market has the potential to affect the pace and depth of penetration of price-responsive demand at the retail level. We agree with Professor Kahn that “retail rates should not be permitted to undermine efficient wholesale rates.”² Conversely, neither should wholesale rate mechanisms, at least those designed in part to compensate for inefficient retail rate designs (such as procuring demand as supply), be allowed hinder the introduction of dynamic pricing mechanisms at the retail level. There is tremendous technical potential for demand response at both the wholesale and retail levels. Use of a ‘net benefits’ test that limits the hours in which wholesale demand response would be dispatched would help to minimize unintended adverse impacts on nascent retail programs.

Conclusion

In closing, NECPUC applauds the Commission for opening this rulemaking proceeding and for issuing the supplemental notice of proposed rulemaking to address the important issues of a net benefits test and cost allocation. As you consider integration of demand response in

² Affidavit of Alfred Kahn at 3-4. Submitted with Reply Comments of the Demand Response Supporters (August 30, 2010).

the final rule, we urge you to (1) require use of a ‘net benefits’ test, (2) refrain from prescribing a standard ‘net benefits’ test, (3) provide clear guidance on the objectives such tests should seek to balance, and (4) require each region to develop its own test consistent with those objectives.

Thank you and I look forward to questions.

Respectfully submitted,

/s/ John J. Keene, Jr.

John J. Keene, Jr.
Director, Regional and Federal Affairs
Massachusetts Department of Public Utilities
One South Station, Second Floor
Boston, MA 02110
Phone: 617-305-3640
Fax: 617-345-9103
E-mail: John.J.Keene@state.ma.us

*On behalf of the New England Conference of Public
Utilities Commissioners*

Date: September 13, 2010