

138 FERC ¶ 61,117
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

California Independent System Operator
Corporation

Docket Nos. ER11-3616-000
ER11-3616-001
ER11-3616-002

ORDER REJECTING TARIFF REVISIONS

(Issued February 16, 2012)

1. On May 20, 2011, the California Independent System Operator Corporation (CAISO) filed, pursuant to section 205 of the Federal Power Act (FPA)¹ and section 35 of the Commission's regulations,² proposed revisions to its tariff to include a Reliability Demand Response Resource product. In this order, we reject the proposed tariff revisions.

I. Background

2. CAISO's Reliability Demand Response Resource proposal is the result of a settlement agreement among CAISO, state investor-owned utilities (IOU), and other interested parties. This settlement agreement was reached after several years of discussions among interested stakeholders and was approved by the California Public Utilities Commission (CPUC).³ CAISO initiated a stakeholder process for the general design of the Reliability Demand Response Resource product in June 2010, which resulted in a final proposal for implementing the Reliability Demand Response Resource product that was approved in November 2010, by the CAISO Governing Board.

3. Subsequent to this approval, CAISO began developing the specific tariff provisions needed to incorporate the Reliability Demand Response Resource product with stakeholder input. CAISO is also developing the related software changes and

¹ 16 U.S.C. § 824d (2006).

² 18 C.F.R. § 35 (2010).

³ CAISO May 20, 2011 Filing at 2 (Reliability Demand Response Filing).

business practice requirements to allow market participation by Reliability Demand Response Resources. CAISO anticipates that these software changes and business practice requirements will be completed in time to permit parties to enter into Demand Response Provider agreements on behalf of Reliability Demand Response Resources and to begin the resource registration process in advance of the program's proposed April 1, 2012 start date.

4. On March 15, 2011, the Commission issued Order No. 745, a Final Rule amending the Commission's regulations under the FPA, regarding compensation for demand response resources participating in wholesale energy markets, i.e., the day-ahead and real-time markets, administered by Regional Transmission Organizations (RTO) and Independent System Operators (ISO).⁴ Specifically, Order No. 745 requires each RTO and ISO to pay a demand response resource the market price for energy, i.e., the locational marginal price (LMP), when two conditions are met. First, the demand response resource must have the capability to balance supply and demand as an alternative to a generation resource. Second, dispatching the demand response resource must be cost-effective as determined by a net benefits test in accordance with Order No. 745. The net benefits test is necessary to ensure that the overall benefit of the reduced LMP that results from dispatching demand response resources exceeds the costs of dispatching and paying LMP to those resources.

5. The Commission explained in Order No. 745 that while dispatching demand response resources results in lower LMPs, transmission constraints may affect which customers benefit from that lower LMP. In hours without transmission constraints, RTOs establish a single LMP for their entire system, in which case demand response would result in a benefit to all customers on the system. In hours when transmission constraints exist, LMPs may vary by zone or other geographic area and dispatching a demand response resource in a particular geographic region may not reduce LMPs system-wide and, consequently, all system customers may not benefit.⁵ Recognizing these circumstances, the Commission required each RTO and ISO to make a compliance filing that either demonstrates that its current demand response cost allocation methodology for the circumstances covered by Order No. 745 appropriately allocates costs to those that benefit from the demand reduction or proposes revised tariff provisions that conform to this requirement.⁶

⁴ *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, 76 FR 16658 (Mar. 24, 2011), FERC Stats. & Regs. ¶ 31,322 (2011), *order on reh'g and clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011).

⁵ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 100.

⁶ *Id.* P 102.

6. On July 22, 2011, CAISO submitted its compliance filing containing tariff revisions regarding its demand response program to comply with Order No. 745. The Commission accepted CAISO's proposal, in part, and rejected the proposal, in part.⁷ Among the Commission's findings was that CAISO had not demonstrated that its demand response cost allocation methodology was compliant with Order No. 745. Therefore, the Commission rejected that methodology.⁸

II. Reliability Demand Response Resource Proposal

7. CAISO claims that its Reliability Demand Response Resource proposal will enable retail emergency-triggered demand response programs, including interruptible, air conditioning, and agricultural pumping load programs, to be integrated into CAISO day-ahead and real-time energy markets. Under CAISO's proposal, a Reliability Demand Response Resource is a load or an aggregation of loads that meets certain requirements and is capable of measurably and verifiably reducing electric demand in response to CAISO dispatch instructions. CAISO states that these resources would be able to bid into the day-ahead energy market like other resources, regardless of whether emergency operating conditions have been met. However, their participation in the real-time energy market would be restricted to periods where certain threshold emergency operating conditions are met. Under the proposal, all Reliability Demand Response Resources are subject to certain qualifications to bid into the CAISO market such as a requirement that the resource load curtailment be no smaller than 0.5 MW, be capable of reaching its maximum load curtailment within 40 minutes, be capable of providing demand response services for four hours, and have a minimum operating time of no more than one hour.⁹ Under CAISO's proposal, Reliability Demand Response Resource loads may be aggregated to reach the 0.5 MW minimum size requirement. In the real-time market, Reliability Demand Response Resource bids must also be at least 95 percent of the allowable maximum bid price and can only be dispatched by CAISO in real-time during a CASIO System Emergency or during a warning notice period.¹⁰

8. CAISO explains that the proposed tariff revisions are based on the existing tariff provisions developed from CAISO's Proxy Demand Resource program.¹¹ Under

⁷ *Cal. Indep. Sys. Operator Corp.*, 137 FERC ¶ 61,217 (2011).

⁸ *Id.* P 45.

⁹ Reliability Demand Response Filing at 11-18.

¹⁰ *Id.*; CASIO December 19, 2011 Deficiency Letter Response at 3-5.

¹¹ Reliability Demand Response Filing at 1 (citing *Cal. Indep. Sys. Operator Corp.*, 132 FERC ¶ 61,045 (2010), *order on compliance and reh'g*, 134 FERC ¶ 61,004 (2011)).

CAISO's proposal, Reliability Demand Response Resources represented by Demand Response Providers¹² may be authorized to take part in CAISO's day-ahead and real-time energy markets. In such cases they must execute a *pro forma* Demand Response Provider agreement with CAISO and satisfy other applicable requirements to participate in the CAISO markets, including requirements of the local regulatory authority.

9. As with Proxy Demand Resources, the process for Reliability Demand Response Resources to participate in the CAISO markets would begin with the registration of the resources by the Demand Response Provider that represents those resources. Through the registration process, the Demand Response Provider would identify the scheduling coordinator that would represent the Reliability Demand Response Resources. Also, certain entities other than CAISO, such as an IOU, may dispatch a Reliability Demand Response Resource in real-time to mitigate a local transmission or distribution system emergency or to perform a test.¹³ Resources dispatched in this manner would not be compensated as Reliability Demand Response Resources in CAISO's markets.

10. In the day-ahead and real-time markets, the scheduling coordinator for a Reliability Demand Response Resource would submit schedules and bids for that resource to curtail load at a pricing node (PNode) or aggregated PNode. The scheduling coordinator that represents the load serving entity where the Reliability Demand Response Resource is located would continue to schedule and bid load at the default load aggregation point, which is less granular than the PNode.

11. CAISO proposes to settle demand response services at the Reliability Demand Response Resource's specified PNode or aggregated PNode. Determination of actual delivery by the Reliability Demand Response Resource would be calculated as the difference between metered load for the Reliability Demand Response Resource and a pre-determined baseline, consistent with the Proxy Demand Resource calculation methodology.¹⁴

12. CAISO proposes to continue to employ the "default load adjustment" when calculating settlement payments. Under the default load adjustment, the quantity of the demand response provided by a Demand Response Provider is added to the measured

¹² CAISO notes that, although Reliability Demand Response Resources are expected to include resources under investor-owned utilities' emergency-triggered programs, other resources that meet the same criteria but are operated by third-party providers can also be designated as Reliability Demand Response Resources. CAISO September 21, 2011 Deficiency Letter Response at 6.

¹³ Reliability Demand Response Filing at 19.

¹⁴ *Id.* at 13.

demand of the scheduling coordinator representing the load serving entity associated with the Reliability Demand Response Resource. This adjustment, according to CAISO, is to prevent that scheduling coordinator and, ultimately, the load serving entity from which the demand response emerges from being compensated for the imbalance energy resulting from the Reliability Demand Response Resource load curtailment.¹⁵ Otherwise, CAISO contends that payment for the demand response and payment for imbalance energy constitutes a double payment.

13. Similar to the Proxy Demand Resource system, CAISO states that the load serving entity and the Demand Response Provider for the Reliability Demand Response Resource may enter into a bilateral agreement that addresses compensation related to Reliability Demand Response Resources being paid as though they are generation.¹⁶ Alternatively, CAISO submits that this compensation issue may be addressed by the applicable rules or regulations of the local regulatory authority. Accordingly, CAISO's tariff does not indicate if and how revenues will be shared between the load serving entity and the Demand Response Provider.

14. CAISO states that although Order No. 745 does not address the default load adjustment directly, it could be interpreted to require the elimination of the default load adjustment. Citing this and other concerns, CAISO notes that it timely filed a motion for clarification and, in the alternative, request for rehearing of Order No. 745.¹⁷

15. CAISO also notes that Order No. 745 expressly exempts from its requirements emergency-triggered demand response programs of RTOs and ISOs that are operated outside of the day-ahead and real-time markets.¹⁸

16. CAISO requests that the Commission make the tariff revisions to the *pro forma* Demand Response Provider agreement effective as of February 20, 2012 and make the remainder of the proposed tariff revisions effective as of April 1, 2012. CAISO requests the earlier effective date for the *pro forma* Demand Response Provider agreement to give CAISO and market participants time to prepare their systems and make other necessary

¹⁵ *Id.* at 24.

¹⁶ *Id.* at 4.

¹⁷ Reliability Demand Response Filing at 24-25 (stating that CAISO requested that the Commission clarify whether Reliability Demand Response Resources are subject to the requirements of Order No. 745).

¹⁸ Reliability Demand Response Filing at 25 (citing Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.4).

arrangements, including communication and registration, for the planned implementation of the Reliability Demand Response Resource proposal in April 2012.

III. Notice and Responsive Pleading

17. Notice of CAISO's filing was published in the Federal Register, 76 Fed. Reg. 30,934 (2011), with interventions and comments due on or before June 10, 2011. Timely Motions to Intervene were filed by NRG Power Marketing LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, Long Beach Generation LLC and NRG Solar Blythe LLC (collectively, NRG); Modesto Irrigation District; MSR Public Power Agency; the City of Santa Clara, California; the Public Utilities Commission of the State of California (CPUC); Northern California Power Agency. Electric Power Supply Association and Southern California Edison Company (SoCal Edison) filed one day out of time.

18. Timely motions to intervene and comments were filed by Pacific Gas and Electric Company (PG&E), California Department of Water Resources State Water Project (SWP). A timely motion to intervene and protest was filed by California Demand Response Advocates (DR Advocates).¹⁹ NRG Companies filed a protest, and CAISO filed an answer.

19. On August 26, 2011, Commission staff issued a deficiency letter identifying specific issues that required additional information. Notice of CAISO's September 21, 2011 response was published in the *Federal Register*, 76 Fed. Reg. 61,094 (2011), with comments due on or before October 12, 2011. On November 18, 2011, Commission staff issued a second deficiency letter requesting additional information regarding the operating conditions required to dispatch Reliability Demand Response Resources in real-time. Notice of CAISO's December 19, 2012 response was published in the *Federal Register*, 76 Fed. Reg. 82,291 (2011), with comments due on or before January 9, 2012.

20. DR Advocates state that under CAISO's existing Proxy Demand Resource program and the Reliability Demand Response Resource proposal LMP is paid to demand response, but that CAISO also increases the charges paid by the host load serving entities in each demand response transaction through the default load adjustment.²⁰ DR Advocates contend CAISO's default load adjustment is inconsistent with Order No. 745, which, according to DR Advocates, modified this cost allocation

¹⁹ DR Advocates are Wal-Mart Stores, Inc., Macy's Inc., Hilton Worldwide, Supervalu, Inc., EnerNOC, Inc., EnergyConnect, Inc., Comverge, Inc., School Project for Utility Rate Reduction, University of California, Safeway, Inc., California State University, Oakley, Inc., and Leggett & Platt.

²⁰ DR Advocates Comments at 3.

mechanism in CAISO's demand response programs.²¹ Thus, DR Advocates state that the Commission must reject the Reliability Demand Response Resource proposal as contrary to Order No. 745.

21. NRG opposes allowing Reliability Demand Response Resources to be dispatched by entities other than CAISO in real-time to mitigate local transmission and distribution system emergencies in isolation from the wholesale markets. NRG claims that this practice will hamper the integration of demand response resources as full participants into the wholesale markets, mask locational price signals, and allow buyer-side entities to exercise market power to suppress prices.²² NRG objects to the possibility of a Reliability Demand Response Resource being dispatched outside the CAISO market and not being included in the CAISO market price. NRG states that CAISO is capable of reflecting these resources in its market pricing even if they are not actually dispatched by CAISO.²³ Finally, NRG argues that denying the opportunity for Reliability Demand Response Resources to set the market price creates perverse incentives for Reliability Demand Response Resources to be used to suppress prices.²⁴

22. SWP states that it is concerned about CAISO's proposal to charge Reliability Demand Response Resources for energy consumption at the default load aggregation point level and compensate these resources at the more granular level.²⁵ SWP notes that CAISO's market surveillance committee has warned that this invites gaming. SWP further states that this mismatch also raises concerns of undue discrimination against loads in low LMP areas.

23. PG&E supports CAISO's Reliability Demand Response Resource proposal, but notes that the proposed tariff language contains some inconsistencies with respect to the statistical performance measurement for Proxy Demand Resources and Reliability Demand Response Resources.²⁶

²¹ *Id.* at 4.

²² NRG Comments at 4.

²³ *Id.* at 7.

²⁴ *Id.* at 10-11.

²⁵ SWP Comments at 2.

²⁶ PG&E Comments at 3.

IV. Discussion

A. Procedural Matters

24. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2011), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

25. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2011), prohibits an answer to a protest unless otherwise ordered by the decisional authority, and the Commission accordingly rejects CAISO's answer.

26. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2011), the Commission will grant Electric Power Supply Association's and SoCal Edison's late-filed motions to intervene given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

B. Substantive Matters

27. The Commission rejects CAISO's Reliability Demand Response Resource proposal, without prejudice to CAISO refile a program which complies with the requirements of Order No. 745. As discussed below, Order No. 745 applies to the Reliability Demand Resource proposal, and the proposal does not comply with Order No. 745. For example, CAISO's proposal relies on a cost allocation methodology that the Commission has rejected because CAISO had not demonstrated that it was compliant with Order No. 745.

28. In its filing, CAISO recognized that Order No. 745 could affect its Reliability Demand Response Resource proposal. CAISO expressed concern that if the Commission directed changes to CAISO's current demand response cost allocation methodology as a result of Order No. 745, that action would impede the implementation of the Reliability Demand Response Resource product.²⁷

29. We agree that Order No. 745 is relevant to our analysis of the Reliability Demand Response Resource proposal. In Order No. 745, the Commission stated that the requirements of the final rule applied to demand response resources participating in day-ahead and real-time markets.²⁸ The Commission finds that CAISO's Reliability Demand Response Resource proposal creates a product designed to allow demand response

²⁷ Reliability Demand Response Filing at 25.

²⁸ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 2 n.4.

resources to participate in CAISO's day-ahead and real-time energy markets. Moreover, the Reliability Demand Response Resource proposal allows demand response resources to submit bids for energy and be committed in the day-ahead market regardless of whether any emergency operating conditions have been met.²⁹ Thus, the requirements of Order No. 745 apply to the Reliability Demand Response Resource proposal.

30. The Commission recently addressed, in an order on CAISO's Order No. 745 compliance filing, the question of whether CAISO complied with Order No. 745 with respect to allocating costs associated with demand response, including its use of the default load adjustment.³⁰ In that order, the Commission found that CAISO had not demonstrated that its cost allocation methodology, including the default load adjustment, was compliant with the requirements of Order No. 745 and, therefore, rejected it.³¹ Because CAISO's Reliability Demand Response Resource proposal relies on the same cost allocation methodology that the Commission recently rejected, we also reject CAISO's Reliability Demand Response Resource proposal without prejudice to CAISO refiling a proposal that is consistent with all the requirements of Order No. 745.

31. In the Commission's order on CAISO's compliance with Order No. 745, we noted that CAISO had included tariff changes regarding the Reliability Demand Response Resource proposal originally proposed in this docket in its Order No. 745 compliance filing. In that order, we stated that issues concerning the Reliability Demand Response Resource proposal would be left to this proceeding.³² Thus, in light of the rejection of the Reliability Demand Response Resource proposal, we expect CAISO to file to remove the tariff provisions that concern Reliability Demand Response Resources that were included in its Order No. 745 compliance filing within 60 days of the date of this order.

²⁹ CAISO September 21, 2011 Deficiency Letter Response at 3; CAISO December 19, 2011 Deficiency Letter Response at 3-5.

³⁰ *Cal. Indep. Sys. Operator Corp.*, 137 FERC ¶ 61,217.

³¹ *Id.* P 45. We note that the Commission has also addressed CAISO's motion for clarification and, in the alternative, request for rehearing of Order No. 745, including issues related to the Reliability Demand Response Resource proposal. In Order No. 745-A, the Commission stated that "we cannot assess these individual aspects of CAISO's demand response program on rehearing in a Final Rule. Other parties need the opportunity to respond to these issues, which are best resolved in CAISO's compliance and Reliability Demand Response Resource proceedings." Order No. 745-A, 137 FERC ¶ 61,215 at P 140.

³² *Cal. Indep. Sys. Operator Corp.*, 137 FERC ¶ 61,217 at P 7.

The Commission orders:

CAISO's tariff revisions for its Reliability Demand Response Resource proposal are hereby rejected, as discussed in the body of this order.

By the Commission. Commissioner Moeller is dissenting with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corp. Docket Nos. ER11-3616-000
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(Issued February 16, 2012)

MOELLER, Commissioner, *dissenting*:

This proceeding exemplifies my concern expressed in dissents on Orders No. 745, 745-A, and CAISO's Order No. 745 compliance filing¹ that promoting demand response would be better served if the regions were free to propose compensation methods that recognize the very real differences in the structures of their regional markets, provided it results in just and reasonable rates that are not discriminatory.² In this case, despite several years of stakeholder efforts resulting in a settlement agreement among CAISO, California IOUs, other interested parties, and approval by the California Public Utilities Commission, the majority rejects CAISO's Reliability Demand Response Resource proposal because the cost allocation does not comply with Order No. 745. This is an unfortunate outcome that may set back CAISO's demand response integration further than Order No. 745 compliance advances it. For that reason, I respectfully dissent.

Philip D. Moeller
Commissioner

¹ *Demand Response Compensation in Organized Wholesale Energy Markets*, 134 FERC ¶ 61,187 (2011) (*Moeller Dissenting*) ("Order No. 745") and *Demand Response Compensation in Organized Wholesale Energy Markets*, 137 FERC ¶ 61,215 (2011) (*Moeller Dissenting*) ("Order No. 745-A"), *Cal. Indep. Sys. Operator Corp.*, 137 FERC ¶ 61,217 (2011) (*Moeller Dissenting*) respectively.

² 16 U.S.C. § 824d (2006).