

144 FERC ¶ 61,046
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

California Independent System Operator
Corporation

Docket No. ER11-4100-001

ORDER DENYING REHEARING

(Issued July 18, 2013)

1. In this order, we deny the California Independent System Operator Corporation's (CAISO) request for rehearing of the Commission's December 15, 2011 order accepting in part and rejecting in part CAISO's tariff revisions regarding its demand response program.¹

I. Background

2. On July 22, 2011, to comply with Commission Order No. 745,² CAISO submitted a compliance filing containing tariff revisions regarding its demand response program. Order No. 745 was a Final Rule amending the Commission's regulations under the Federal Power Act (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). 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

¹ *Cal. Indep. Sys. Operator Corp.*, 137 FERC ¶ 61,217 (2011) (December 15 Compliance Order).

² *Demand Response Compensation in Organized Wholesale Energy Markets*, Order No. 745, 76 FR 16,658 (Mar. 24, 2011), FERC Stats. & Regs. ¶ 31,322 (2011), *order on reh'g and clarification*, Order No. 745-A, 137 FERC ¶ 61,215 (2011).

demand response resources exceeds the costs of dispatching and paying LMP to those resources.

3. In order to implement the net benefits test, the Commission directed each RTO and ISO to develop a mechanism to approximate the price level at which dispatching demand response resources will be cost-effective. The Commission required each RTO and ISO to make a compliance filing by July 22, 2011, proposing tariff revisions necessary to implement the compensation approach adopted in Order No. 745, including the net benefits test. Order No. 745 also directed that the compliance filing either demonstrate that the RTO or ISO's current cost allocation methodology appropriately allocates cost to those that benefit from the demand reduction or propose revised tariff provisions that conform to this requirement.³

4. CAISO's compliance filing included modifications to its existing Proxy Demand Resource program. CAISO proposed to apply a net benefits test to determine whether demand response bids qualify for such resources to be included in a schedule. The Commission accepted CAISO's net benefits test but directed CAISO to make a compliance filing within 90 days that addressed certain posting and information sharing requirements and relocated information regarding the development of the net benefits test threshold price from the business practice manual to the CAISO tariff.⁴ The Commission also rejected CAISO's proposal to exclude demand response bids from the market that were below the net benefits test's threshold price.⁵

5. CAISO's compliance filing did not propose any modification to its cost allocation methodology, rather CAISO argued that its existing methodology appropriately allocates costs to those that benefit from demand response because in the CAISO market, day-ahead load and deviations in real-time pay.⁶ Under CAISO's existing Proxy Demand Resource program, the total amount of Proxy Demand Resource energy measurement (calculated by comparing the customer baseline of a Proxy Demand Resource against its actual underlying load for a demand response event) is added to the demand of the load serving entity in which the Proxy Demand Resource is located. CAISO stated that this add-back (referred to as the "default load adjustment") is intended to prevent the load serving entity from being compensated for demanding less energy than scheduled in the day-ahead market because of the Proxy Demand Resource's load reduction, which effectively makes the host load serving entity pay for the demand response.

³ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 102.

⁴ December 15 Compliance Order, 137 FERC ¶ 61,217 at PP 29-30.

⁵ *Id.* P 31.

⁶ CAISO Compliance Filing at 15.

6. In the December 15 Compliance Order, the Commission found that CAISO did not demonstrate that its cost allocation methodology, including the default load adjustment, which we found allocates the cost of demand response to the host load serving entity, appropriately allocates costs to those that benefit from the demand reduction.⁷ The Commission added that CAISO's argument that costs are allocated to the load that benefits from the price reductions, which CAISO characterizes as all load in the day-ahead market and deviations from day-ahead schedules in the real-time market, ignores the effect of the default load adjustment.⁸ The Commission directed CAISO to file a compliant cost allocation methodology within 90 days after the issuance of the December 15 Compliance Order.

7. Also on December 15, 2011, the Commission issued Order No. 745-A, which addressed rehearing and clarification requests regarding Order No. 745.⁹ In Order No. 745-A, the Commission addressed the rehearing and clarification requests that were limited to CAISO-specific programs and found that those issues were more appropriately addressed in this compliance proceeding and other proceedings.¹⁰

8. On January 17, 2012, CAISO filed a timely request for rehearing.¹¹

II. Request for Rehearing

9. CAISO seeks rehearing of the Commission's direction that CAISO eliminate the use of the default load adjustment mechanism for transactions subject to the requirements of Order No. 745.¹² CAISO argues that the December 15 Compliance Order mischaracterizes the default load adjustment. CAISO notes that the Commission found that the default load adjustment allocates to the host load serving entity the entire cost of the revenue shortfall caused by the demand response purchase and does not allocate the cost of the demand response purchase proportionally to the entities that benefit.¹³ However, CAISO contends that payments of LMP made to demand response resources

⁷ December 15 Compliance Order, 137 FERC ¶ 61,217 at PP 45, 46.

⁸ *Id.* P 46.

⁹ Order No. 745-A, 137 FERC ¶ 61,215.

¹⁰ *Id.* PP 140-141.

¹¹ California Independent System Operator Corporation January 17, 2012 Request for Rehearing (CAISO Rehearing Request).

¹² Rehearing Request at 2.

¹³ *Id.* at 19 (citing December 15 Compliance Order, 137 FERC ¶ 61,217 at P 43).

are allocated to the load that benefits from the demand response reduction, i.e., to all load day-ahead and to deviation in real-time, consistent with the requirements of Order No. 745.¹⁴

10. CAISO adds the purpose of the default load adjustment is to eliminate the potential for wholesale double payment for the same curtailment: first, when it pays the demand response provider's scheduling coordinator for the load reduction; and second, when the host load serving entity would have an imbalance energy adjustment resulting from the decreased load in its area because of the demand response load curtailment.¹⁵

11. CAISO provides an example regarding the use of the default load adjustment and contends that the day-ahead and real-time cost of the demand response purchase is not allocated solely to the host load serving entity. Also, CAISO contends that the default load adjustment does not allocate any "revenue shortfall." Rather, CAISO states that in its example the load serving entity pays for day-ahead scheduled load at the day-ahead settlement price and the default load adjustment is solely for purposes of calculating uninstructed deviations and avoiding paying the load serving entity for uninstructed deviations based on the curtailed MW amount in addition to paying the demand response provider for energy from the curtailment.¹⁶

12. CAISO also claims that the Commission is mistaken in asserting that CAISO indicated that any issues regarding the default load adjustment would be resolved by the California Public Utilities Commission (CPUC), potentially through bilateral agreements.¹⁷ CAISO maintains that any compensation or revenue-sharing issues between a load serving entity and a demand response provider on the retail level are independent of the cost allocation set forth in the tariff.¹⁸

13. CAISO further argues that the Commission did not address its contention that the retention of the default load adjustment is consistent with or superior to the requirements of Order No. 745.¹⁹ CAISO states that in its compliance filing it noted that Order

¹⁴ *Id.* at 23.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at 24 (citing December 15 Compliance Order, 137 FERC ¶ 61,217 at P 6 n.4).

¹⁸ *Id.* at 25.

¹⁹ *Id.*

No. 745 provided that “[i]n its compliance filing an RTO or ISO may attempt to show, in whole or in part, how its proposed or existing practices are consistent with or superior to the requirements of [Order No. 745].”²⁰ CAISO claims that elimination of the default load adjustment damages CAISO’s ability to implement Proxy Demand Resource functionality in its market and the ability of the CPUC to approve related retail demand response programs and financial settlement mechanisms. CAISO adds that retention of the default load adjustment is therefore a superior means for achieving meaningful demand response in California wholesale electricity markets.²¹

14. CAISO claims the Commission’s determination is an unexplained departure from precedent because the Commission’s direction impermissibly reverses Order No. 719.²² CAISO states that in Order No. 719, the Commission specifically declined to mandate a solution to the wholesale double payment issue and instead found that each region should propose its own solution for Commission acceptance. CAISO adds that in Order No. 719, in response to the “double payment” issue, the Commission stated that “[s]uch issues are more appropriately addressed by each region in its compliance filing if it chooses to do so.”²³ CAISO maintains that because the Commission already set forth in Order No. 719 its policy of granting ISOs and RTOs the flexibility to deal with the wholesale double payment issue, it cannot modify that Order No. 719 policy directive, either explicitly or implicitly, without full notice and an opportunity for comment.²⁴ CAISO maintains that the December 15 Compliance Order was not issued in a rulemaking proceeding and provided no notice or opportunity for comment. Also, CAISO states that although the Commission is free to revise its policies established in a prior rulemaking, it must acknowledge it is doing so and provide a reasoned explanation.²⁵ CAISO contends that since the Commission does not acknowledge it is revising portions of Order No. 719, it has not met the prerequisites for doing so.

15. Also, CAISO contends that the December 15 Compliance Order does not include a finding that the default load adjustment market feature is no longer just and reasonable

²⁰ *Id.* (quoting Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 4 n.7).

²¹ *Id.* at 26-27.

²² *Id.* at 28 (citing *Wholesale Competition in Regions with Organized Electric Markets*, Order No. 719, 73 Fed. Reg. 64,100 (Oct. 28, 2008), FERC Stats. & Regs. ¶ 31,281 (2008)).

²³ *Id.* (quoting Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 159).

²⁴ *Id.* at 29.

²⁵ *Id.*

for certain transactions, as required by FPA section 206. CAISO adds that even if such a finding was implicit in the order, the order lacks any reasoned explanation of such a finding.²⁶ CAISO states that section 206 of the FPA gives the Commission authority to “‘determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force’ only if it first finds that any existing arrangement ‘is unjust, unreasonable, unduly discriminatory or preferential.’”²⁷ CAISO argues that absent a finding supported by substantial evidence that existing rates are no longer just and reasonable, the Commission cannot require modifications to them.²⁸ CAISO continues that merely implying that the default load adjustment is unjust and unreasonable absent an explanation or any evidence of problems created by the default load adjustment is not a legally sufficient basis under FPA section 206 to overturn the existing rates.²⁹

16. CAISO also states that the elimination of the default load adjustment only applies to some demand response transactions in the CAISO wholesale markets but not to others. CAISO contends that because this proceeding only addresses situations where a demand response resource is paid an LMP greater than or equal to the net benefits test threshold price, the elimination of the default load adjustment does not apply when a demand response resource is dispatched but the LMP is less than the threshold price. CAISO adds that the Commission does not provide an explanation why the default load adjustment is no longer just and reasonable when the LMP is greater than or equal to the net benefits test threshold price but remains just and reasonable when the LMP is less than the net benefits test threshold price.³⁰

17. CAISO maintains that the default load adjustment is an essential feature of the demand response design, and if the design of the tariff revisions regarding proxy demand resources must be modified pursuant to the December 15 Compliance Order, it will introduce uncertainty regarding the CPUC’s ongoing proceedings on the terms under which utilities can bid demand response as proxy demand resources. CAISO adds that the CPUC has informed CAISO that to the extent Order No. 745 mandates wholesale

²⁶ *Id.* at 29-30.

²⁷ *Id.* at 30 (citing *Panhandle Eastern Pipe Line Co. v. FERC*, 907 F.2d 185, 188 (D.C. Cir. 1990)).

²⁸ *Id.* at 30 (citing *Fed. Power Comm’n v. Sierra Pacific Power Co.*, 350 U.S. 348, 372 (1956); *Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002)).

²⁹ *Id.* at 31 (citing *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 958 (D.C. Cir. 1983)).

³⁰ *Id.* at 32.

double payments to load serving entities that are also demand response providers, the CPUC reserves the right to revisit its determinations conditionally authorizing entities subject to the CPUC's jurisdiction to participate in the CAISO market as Proxy Demand Resources.³¹ CAISO contends such an action by the CPUC could have crippling effects on the provision of demand response in California.

18. CAISO argues that the December 15 Compliance Order intrudes on the CPUC's jurisdiction.³² CAISO contends that requiring a change to the default load adjustment or the provision of wholesale double payments to load serving entities that are also demand response providers impedes the CPUC's efforts on demand response. CAISO states that because the December 15 Compliance Order requires such changes, it intrudes on state jurisdiction.³³

Commission Determination

19. We deny CAISO's request for rehearing. In Order No. 745, the Commission noted that, when a demand response provider curtails and is paid the LMP, "the amount owed by the RTO to resources, including demand response providers, and the revenue it derives from load results in a negative balance" because when demand response is dispatched, the amount of load paying the LMP is reduced while the resources paid the LMP remain constant.³⁴ To account for this effect, the Commission stated that costs associated with this negative balance must be addressed through cost allocation, and that the costs must be allocated to those that benefitted from the price reduction associated with decreased demand.³⁵ To implement this requirement, the Commission, acting under FPA section 206, directed CAISO and other ISOs and RTOs to either demonstrate that their current demand response cost allocation methodology appropriately allocated costs to those that benefitted from decreased demand or propose revised tariff provisions that appropriately allocate costs.

³¹ *Id.* at 34.

³² *Id.* at 35.

³³ *Id.*

³⁴ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 99.

³⁵ *Id.* PP 100-102. The Commission explained that such costs should be allocated proportionately to all entities that purchase from the relevant energy market in the area(s) that benefit from the lower LMPs that result from demand response resource participation. Order No. 745-A, 137 FERC ¶ 61,215 at P 5.

20. Order No. 745 also allowed each region to develop cost allocation methodologies to reflect regional variations in determining the area(s) in which market participants benefit from demand response participation.³⁶ As the Commission stated in Order No. 745-A, “[t]he Final Rule also recognized that RTOs and ISOs may have different cost allocation and measurement and verification programs. Each of these elements can be addressed on an individual basis through the RTO and ISO compliance filings.”³⁷ In making these statements, the Commission stated that its action “was designed to allow sufficient flexibility for each individual RTO and ISO to determine, in consultation with their stakeholders, an appropriate cost allocation methodology *that complies with the Final Rule*.”³⁸ Thus, the Commission offered flexibility with respect to how each RTO or ISO complied with the above-noted, cost allocation requirement of Order No. 745. That flexibility, however, does not supersede the requirement.

21. Since CAISO did not propose any revised tariff provisions for its cost allocation, the December 15 Compliance Order focused on CAISO’s demonstration regarding its existing cost allocation methodology. The Commission found CAISO’s arguments regarding its existing cost allocation methodology, including the default load adjustment, did not comply with Order No. 745 because CAISO did not demonstrate that it appropriately allocated costs to those that benefitted from decreased demand and that only the host load serving entity benefits from the decreased demand.³⁹

22. We disagree with CAISO’s argument on rehearing that the December 15 Compliance Order mischaracterizes the default load adjustment’s effect on the allocation of cost for demand response. CAISO argues that its tariff allocates the cost of payments to demand response providers to the load that benefits from the demand reduction (all load day-ahead and to deviations in real-time). CAISO’s argument is not persuasive because it ignores the cost allocation effects of the default load adjustment.⁴⁰

23. The default load adjustment adds the amount of demand response provided to the total load of the host load serving entity. The default load adjustment thus allocates the

³⁶ Order No. 745-A, 137 FERC ¶ 61,215 at P 115.

³⁷ *Id.* P 75.

³⁸ *Id.* P 115 (emphasis added).

³⁹ December 15 Compliance Order, 137 FERC ¶ 61,217 at PP 45, 46.

⁴⁰ *Id.* P 43.

cost of demand response to the host load serving entity, since the load serving entity must pay for additional load that it does not serve as a result of the demand reduction.⁴¹

24. This result is contrary to our direction in Order No. 745. As the Commission stated in the December 15 Compliance Order, CAISO was directed in Order No. 745 to either demonstrate that its current cost allocation methodology appropriately allocates cost to those that benefit from the demand reduction or propose revised tariff provisions that conform to this requirement.⁴² CAISO did not demonstrate that the benefits of demand response are limited to the host load serving entity, and thus it did not demonstrate that its cost allocation methodology conformed to the Order No. 745 requirement.⁴³

25. CAISO claims that the default load adjustment does not allocate any “revenue shortfall.” However, CAISO contradicts this statement by acknowledging that, without the default load adjustment, an additional cost resulting from paying LMP to demand response providers would be allocated to “load or other market participants as uplift.”⁴⁴ Therefore, CAISO’s claim is unsupported.

26. Although CAISO states that it did not indicate that any issues regarding the default load adjustment would be resolved by the CPUC, potentially through bilateral agreements, the Commission notes that when CAISO originally submitted the Proxy Demand Resource proposal, it stated:

separate agreement[s] entered into by ... [demand response providers and load serving entities] or the applicable local regulatory authority rules will provide the means for the demand response provider and the load serving entity to share the ISO revenues, in order to compensate the load serving entity for the energy that is purchased by the load serving entity but is not

⁴¹ CAISO acknowledges in its example that the cost of the demand response is allocated to the “buyers of energy, i.e., the scheduling coordinators for the [load serving entity].” Rehearing Request at 22.

⁴² December 15 Compliance Order, 137 FERC ¶ 61,217 at P 45 (citing Order No. 745, FERC Stats. & Regs. ¶ 31,322 at P 102).

⁴³ *Id.* P 46.

⁴⁴ Rehearing Request at 22.

used due to the demand response service provided by the proxy demand resource.^[45]

27. As discussed above, the default load adjustment causes the host load serving entity to pay for energy that it does not serve as a result of demand response. Thus, the December 15 Compliance Order's reference to the separate bilateral contract and/or local regulatory authority addressing the load serving entities paying for load it does not ultimately serve is not mistaken. Further, just as in the December 15 Compliance Order and the original order on Proxy Demand Resources, the Commission here does not address those potential contracts or the CPUC process.

28. CAISO contends that the elimination of the default load adjustment would damage CAISO's ability to implement the proxy demand resource functionality and the ability of the CPUC to approve related retail demand response programs and financial statement mechanisms. Thus, according to CAISO, retention of the default load adjustment is a superior means for achieving demand response in California wholesale electricity markets. We find that this speculative statement is an insufficient basis to justify a failure to comply with the Commission's requirement that CAISO's cost allocation methodology at issue here allocates costs to those that benefit from the demand reduction. CAISO's statement that it has planned on employing the default load adjustment for its demand response programs and that any changes to that methodology complicates its plans does not show that the use of the default load adjustment is consistent with or superior to the requirements of Order No. 745.

29. The December 15 Compliance Order also is not an unexplained departure from Order No. 719. The language that CAISO cites from Order No. 719, stating that "so called 'double payment'" is an "issue[] more appropriately addressed by each region in its compliance filing if it chooses to do so,"⁴⁶ is not reasonably read as guaranteeing CAISO complete flexibility to address that issue in any manner that it might choose. Moreover, even if the Commission in Order No. 719 had provided the broad flexibility that CAISO claims, the Commission could narrow that flexibility through subsequent action such as Order No. 745. As discussed above, in Order No. 745, the Commission directed ISOs and RTOs to either demonstrate that they are already allocating the costs at issue consistent with the requirements of Order No. 745 or change their cost allocation method to ensure that it does so. The December 15 Compliance Order applies this direction from Order No. 745.

⁴⁵ PDR Transmittal at 10-11, ER10-765-000 (February 16, 2010); *see also*, CAISO Tariff Appendix B.14 at § 4.3.

⁴⁶ Order No. 719, FERC Stats. & Regs. ¶ 31,281 at P 159.

30. CAISO's arguments that there was not the opportunity for notice and comment on the Commission direction or that the Commission did not specifically find CAISO's default load adjustment unjust and unreasonable ignores the Order No. 745 rulemaking proceeding. This issue regarding cost allocation was included in the Supplemental Notice of Proposed Rulemaking that preceded Order No. 745.⁴⁷ Parties, including CAISO, commented on this issue.⁴⁸ In fact, CAISO commented specifically about the effect of the Commission's proposal on the default load adjustment. Similarly, in Order No. 745, the Commission noted that one of the cost allocation methods included in the comments was "assignment of costs to the load serving entity...associated with the demand response provider," and the Commission rejected this method finding it an arbitrary division of cost responsibility.⁴⁹

31. Further, as mentioned above, the Commission is operating within its authority under FPA section 206, and is not required to make case-by-case, specific findings in the context of a rulemaking proceeding.⁵⁰ As the Commission explained in Order No. 745-A:

Under the exercise of the Commission's authority under section 206 of the FPA, the Commission determined that any energy market demand response program is unjust and unreasonable if it does not ... allocate costs appropriately to those parties that benefit from the reduction in LMP occasioned by the demand response.^[51]

The Commission added that it had "an adequate basis for making these determinations on a generic basis."⁵²

32. CAISO correctly notes that Order No. 745 is confined to situations where a demand response resource has the capability to balance supply and demand as an alternative to a generation resource, and where dispatch of the demand response resource

⁴⁷ *Demand Response Compensation in Organized Wholesale Energy Markets*, 132 FERC ¶ 61,094 (2010).

⁴⁸ See Order No. 745, FERC Stats. & Regs. ¶ 31,322 at PP 97 – 98.

⁴⁹ *Id.* PP 97, 101.

⁵⁰ *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1008 (D.C. Cir 1986).

⁵¹ See Order No. 745-A, 137 FERC ¶ 61,215 at P 140.

⁵² *Id.*

is cost effective as determined by a net benefits test.⁵³ Thus, the December 15 Compliance Order's direction regarding the default load adjustment is also confined to instances when demand response is dispatched when the LMP is at or above the threshold price.

33. CAISO's argument regarding CPUC jurisdiction is not persuasive. The Commission has demonstrated that it has jurisdiction over demand response participation in organized wholesale energy markets because of the effect of demand response and related RTO and ISO market rules on Commission-jurisdictional rates, and we need not repeat that explanation here.⁵⁴ The Commission has also explained that while participation in a Commission-jurisdictional RTO or ISO may indirectly affect incentives in a state demand response initiative, this fact does not deprive the Commission of the ability to act within the Commission's jurisdictional boundaries.⁵⁵

The Commission orders:

CAISO's request for rehearing is hereby denied.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

⁵³ See December 15 Compliance Order, 137 FERC ¶ 61,217 (citing Order No. 745-A, 137 FERC ¶ 61,215 at P 131).

⁵⁴ Order No. 745, FERC Stats. & Regs. ¶ 31,322 at PP 64 (citing *EnergyConnect*, 130 FERC ¶ 61,031 (2010)); Order No. 745-A at PP 20-35.

⁵⁵ Order No. 745-A at P 32.