



# Order 745 Revisited, Upheld

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**F**ederal Energy Regulatory Commission (FERC) Order 745, *Demand Response Compensation in Organized Wholesale Energy Markets*, issued March 15, 2011, amended FERC regulations under the Federal Power Act. The order was to ensure that when demand-response resources are made available as an alternative to generation resources, they be paid the same prevailing locational marginal price (LMP).

Compensating demand-response resources in this way helps balance markets and removes barriers to the participation of demand-response resources in wholesale electricity markets. In theory, electricity customers would be indifferent as to whether market supply and demand balanced by generators or reduced demand. Simply speaking, then, logic follows that both resource types should be valued and compensated the same.

The concept is similar in nature to the regulatory paradigm of the late 1980s when regulators required that demand- and supply-side resources compete to meet new resource needs. This requirement was prevalent in a handful of states at the time, thus ensuring that markets were efficient and that demand and supply resources were able to compete openly. Utilities seeking new resources were required to allow demand- and supply-side resources to compete on equal footing.

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In some cases, as in New York and California, an environmental externality adder was included in the bid evaluation process to recognize and quantify the avoided air pollutant emissions benefits from demand reduction. In such instances, when the economics proved out, demand growth was met with energy-efficiency improvements and demand reductions and compensated accordingly. In a New York State Electric and Gas “demand and supply bidding procurement,” for example, the State Energy Office led an effort to propose an energy efficiency and load management initiative aggregating a wide variety of energy efficiency and demand management measures and initiatives. It was proposed to meet a portion of the utility's projected energy and demand growth.<sup>1</sup> The bid proposal was accepted, and measures installed, and payments made as bid for the reductions.

### SAME CONCEPT, DIFFERENT MARKETING AND VALUATION

The concept of valuing demand-response resources in a manner similar to generation is not new.

What has changed is the manner in which such resources are now marketed, customers acquired, and services sold into markets. FERC has the authority and is responsible for regulating wholesale electricity markets. FERC Order 745 prescribed rules for compensating demand-response resources in wholesale electricity markets, attempting to assign appropriate “value” to demand-response resources. As expected, many generators and industry associations opposed compensating such resources in this manner.

Incumbent providers in the electricity industry were perfectly happy not to face new competition in the form of a more-robust demand-response market in the United States. As a result, they litigated FERC's Order, arguing that demand response was in essence

a “retail” service and thus not subject to FERC’s jurisdiction. The retail side of the electricity business falls under the purview and regulatory jurisdiction of states. Order 745 opponents argued that FERC was capricious and arbitrary with its rulemaking.

Demand-management technologies and providers have matured significantly over the years and are now active participants in wholesale electricity markets.<sup>2</sup> Demand response results in load shedding at the time of system peak and represents a revenue gain to demand-response providers and a revenue loss or opportunity cost to generators.

### GENERATORS ARGUE THAT DEMAND-RESPONSE PROVIDERS BENEFIT UNDULY

Opponents of Order 745 argued that the process was unfair and that demand-response providers benefited from two revenue streams: first, LMPs paid for demand response provided; and second, the direct savings from avoided market purchases of energy and capacity.

They argued that this created an uneven playing field, skewing the market in favor of demand response and suppressing prices paid to generators. The revenue streams are no different than the revenue provided to generators who install distributed energy resources at a customer site and net meter electricity back to the local utility. The deal between the host site and third-party provider is incidental to the resource being provided back to the utility in the form of new supply or demand reduction.

The challenge to FERC was led by utility groups, including the Electric Power Supply Association, American Public Power Association, and Edison Electric Institute, to name a few. In a filing with the US Court of Appeals for the District of Columbia Circuit, plaintiffs argued that FERC exceeded its authority to regulate retail services like demand response in wholesale energy and capacity markets of regional transmission organizations. Specifically included are ISO New England, New York ISO, and Mid-Atlantic grid operator PJM. Plaintiffs argued that FERC did not have the authority to regulate retail services (i.e., demand-response participation) in wholesale energy and capacity markets.

On the other hand, demand-response providers supported FERC, arguing that Order 745 provided a fair way to compensate customers for costs incurred implementing real-time demand response. If the past is any precedent, even if such arguments

were not part of court pleadings, regulators and many market participants have no objection to such competition to meet demand as long as market rules are not discriminatory, and clear.


### SUPREME COURT SIDES WITH FERC

On May 23, 2014, the DC Circuit vacated Order 745, causing great consternation and uncertainty in markets. FERC appealed the decision to the US Supreme Court following the lower court’s decision arguing that it did indeed have such authority and that the rule was not arbitrary or capricious. The Supreme Court overturned DC Circuit’s ruling on January 25, 2016.

The court found that FERC’s decision to compensate demand-response providers at LMP—the same price paid to generators—is not arbitrary and capricious.<sup>3</sup> The Supreme Court found that FERC engaged in reasoned decision-making and that FERC considered competing views and opinions. Further, it found that FERC’s compensation formula was supported by the record, with full explanation of its decision.

### CONCLUSIONS

Perhaps a simple way to think of this is the following: (1) paying demand-response resources at a price competitive with generation is not new or without precedent; (2) the benefit of a market payment and savings from reducing demand amounts to the equivalent of excess earnings that any market participant reaps if conditions warrant, until markets reach a point of equilibrium; and (3) competitive markets thrive when rules are clear, information and risks and rewards are known with some certainty, and barriers to entry are low.

Now, let’s get on with it. 

### NOTES

1. DeCotis, P., Barnes, P., & Platt, B. (1991). State Facilities Energy Conservation Project. Proposal submitted on behalf of the State of New York to the New York State Electric and Gas Company in its demand management resource competitive bidding solicitation. \$6.5 million winning proposal. Albany, NY: New York State Energy Office. See also Barnes, P., DeCotis, P., & Platt, B. (1992, April). A state government bidder’s experience and perspective. In *DSM bidding: Status and results* (pp. TK–TK). Bala Cynwyd, PA: Synergic Resources Corporation.
2. DeCotis, P. (2009, June). Coming of age in New York: The maturation of energy efficiency as a resource. *The Bridge*, 39(2), 37–43.
3. An argument made by opponents was that demand response should be paid a price “LMP-G” defined as LMP minus the retail price of electricity, which represents the benefit to demand-response customers from reducing usage.