UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Demand Response Compensation in Organized Wholesale Energy Markets	**Docket Nos. RM10-17-000, EL09-68-000**

COMMENTS OF THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

The New York Independent System Operator, Inc. ("NYISO") submits these comments in response to the Commission's August 2, 2010 *Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference*.[1] In the Supplemental Notice, the Commission sought further input on two issues: its proposal to adopt a "net benefits" test for demand response compensation, and the proper allocation of the costs of demand response.

The NYISO respectfully points out that the need for a net benefits test and accompanying cost allocation procedure follows directly from the Commission's proposal to pay demand response resources the locational market price of energy ("LMP") for their demand reductions. As the NYISO and several other parties to this proceeding have noted,[2] paying demand response LMP minus a proxy cost for their retail rate ("LMP-G") provides the correct economic signals within a wholesale market framework, avoids the need for complicated and contentious net benefits tests and cost allocation rules, and comports much more closely to the outcomes derived from dynamic retail pricing. The NYISO shares the concern expressed in this proceeding that a net benefits test "could have the unintended consequence of retarding the development of price responsive demand."[3]

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[1] Demand Response Compensation in Organized Wholesale Energy Markets, Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference, 75 Fed. Reg. 47,499 (August 6, 2010), 132 FERC ¶ 61,094 (August 2, 2010) ("Supplemental Notice").

[2] *See*, e.g,. Comments of ISO New England Inc. Internal Market Monitor, at 5 (May 13, 2010); Comments of ISO/RTO Council, White Paper entitled Demand Response Pricing in Organized Wholesale Markets, by William J. Hogan at 11-12 (May 13, 2010).

[3] Speaker Materials of Commissioner Paul A. Centolella, Publice Utilities Commission of Ohio, at 2 (September 13, 2010).

I. Communications and Correspondence

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II. Background

In the March 18, 2010 notice commencing the present proceeding, the Commission proposed to require Independent System Operators and Regional Transmission Organizations with demand response programs to pay LMP to those resources for their demand reductions, in all hours.[4] The NYISO submitted its comments on the Commission's proposal on May 13, 2010 and also filed comments on behalf of the ISO/RTO Council. Both sets of comments supported an alternative approach to compensation: the NYISO and the Council urged the Commission to adopt the formula put forward by Professor William Hogan that would pay load serving entities ("LSEs") LMP minus "an imputed amount reflecting some (or all) components of the retail rate" ("LMP-G").

The Commission also received various submissions suggesting that LMP should be paid for demand response only "when the benefits of demand response compensation outweigh the costs of paying demand response resources, as determined by some type of net benefits test."[5] In the Supplemental Notice, the Commission seeks further elaboration on how the Commission should define and implement a net benefits test for the application of LMP, and how the

[4] Demand Response Compensation in Organized Wholesale Energy Markets, Notice of Proposed Rulemaking, 75 Fed. Reg. 15, 362 (March 29, 2010), 130 FERC ¶ 61, 213 (March 18, 2010).

[5] Supplemental Notice, at 7-8.

Commission should allocate the costs of demand response compensated according to such a formula.

II. Comments

The NYISO continues to believe that the LMP-G approach provides an efficient incentive for demand resources to participate in the wholesale markets, and that a requirement to pay LMP would impose unnecessary costs on customers, create distorted incentives, and hinder the introduction of other clean technologies by suppressing real time prices. The NYISO further notes that a rule mandating payment of LMP-G avoids the need to develop a net benefits test. As stated by Dr. Roy Shanker on behalf of the PJM Power Providers, the LSE and the customer receive appropriate payments under the LMP-G approach: "The LSE pays the customer the difference between LMP and … what they would have paid under their retail rate ... which is their net benefit of not consuming the power."[6]

In addition, the LMP-G formula does not require the Commission and the ISOs/RTOs to develop cost allocation mechanisms. Again, as Dr. Shanker notes, an LMP-G payment imposes the financial consequences of the load reduction on "the LSE (who is held harmless by such payments) and the conserving customer... There are no transfers from other parties and thus no costs to allocate."[7] Thus, aside from its inherent non-discriminatory nature, application of the LMP-G formula does not require market operators and market participants to engage in difficult and potentially lengthy deliberations about the design of cost allocation mechanisms.

Should the Commission nevertheless decide to move forward with a full LMP payment for demand response, the NYISO urges the Commission to craft a net benefits test that minimizes any opportunities for distorting market prices or exploiting market inefficiencies. In his comments at the September 13th Technical Conference, Professor Hogan pointed out that "…a net benefits test should ensure that the demand response program does not have negative net benefits compared to no program at all. The criterion to apply would focus on the bid-cost

[6] Speaker Materials of Dr. Roy Shanker, PJM Power Providers Group, at 3 (September 13, 2010).

[7] *Id.*

savings of generation and load, with the load bids adjusted for the effects of avoidance of the retail rate."[8]

The LMP approach also drives the necessity of developing market-specific cost allocation rules to ensure that energy market settlements are made whole with respect to payments to demand response resources. If the Commission determines to pursue this course, the NYISO concurs with Professor Hogan in his view that:

> "The costs of the program should be allocated to the load serving entity. For efficient pricing, this cost allocation would emulate the effect of a contract and leave the load serving entity no worse off than without the demand response transaction. If the purpose of demand response goes beyond removing the barriers for efficient market participation, such as to capture other environmental benefits or the future cost reductions of learning-by-doing, part of the cost recovery would be separate from the allocation to the load serving entity. In this case the benefits would presumably be widely shared, and the costs should be recovered from a broader group, typically all loads."[9]

III. Conclusion

The NYISO respectfully requests that the Commission consider these comments and reject the full LMP compensation formula for demand response. In the alternative, if the Commission concludes that full LMP represents the just and reasonable rate, the NYISO urges the Commission to allow each wholesale market to develop net benefits tests and cost allocation methodologies tailored to their specific market designs.

Respectfully submitted,

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[8] Comments of William Hogan, at 6 (September 13, 2010).

[9] *Id*. at 7.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Rules of Practice and Procedure, 18 C.F.R. §385.2010.

Dated at Rensselaer, NY this 13th day of October, 2010

/s/ Joy A. Zimberlin

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