

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

COMMENT OF THE FEDERAL TRADE COMMISSION
October 13, 2010

Background and Summary

The Federal Trade Commission (FTC) appreciates this opportunity to comment on the Federal Energy Regulatory Commission's (FERC's) Supplemental Notice of Proposed Rulemaking and Notice of Technical Conference (Supplemental NOPR) regarding demand response compensation in organized wholesale energy markets. *Demand Response Compensation in Organized Wholesale Energy Markets*, Docket No. RM10-17-000, 132 F.E.R.C. ¶ 61,094.¹ The primary questions articulated in the Supplemental NOPR are (1) what kind of net benefits test should be applied for determining demand response compensation and (2) what the objectives of any such test should be.

As discussed below, there is no need for a net benefits test so long as FERC utilizes efficient prices in compensating demand response providers, because efficient prices will elicit efficient levels of demand response. Efficient price signals also will encourage efficient investments in demand response technologies. The proposal to implement a net benefits test as a screen arises as a policy issue only if FERC sets inefficiently high compensation levels for demand response (*i.e.*, compensation that does not deduct the cost of the power that the demand response provider is reselling).

We encourage FERC to adopt efficient pricing for demand response compensation. If FERC does so, it can avoid the need to devise administrative means to trim excess demand response. Excess demand response is likely if FERC compensates demand response at the level of the full locational marginal price (LMP) for retail customers who pay flat retail rates. Although it may be tempting to try to use an excessive demand response compensation level to make up for LMPs that are deficient, such an approach is likely to create its own inefficiencies. These defects are likely to increase over time as existing and potential providers invest in demand response technology in response to the inefficient price signals.

¹ 75 Fed. Reg. 47499 (Aug. 6, 2010).

Interest of the Federal Trade Commission

The FTC is an independent agency of the United States Government responsible for maintaining competition and safeguarding the interests of consumers, both through enforcement of the antitrust and consumer protection laws and through competition policy research and advocacy. The FTC often analyzes regulatory or legislative proposals that may affect competition or allocative efficiency in the electric power industry. The FTC also reviews proposed mergers that involve electric and natural gas utility companies, as well as other parts of the energy industry. In the course of this work, as well as in antitrust and consumer protection research, investigation, and litigation, the FTC applies established legal and economic principles and recent developments in economic theory and empirical analysis.

The energy sector, including electric power, has been an important focus of the FTC's antitrust enforcement and competition advocacy.² The FTC's competition advocacy program has produced two staff reports on electric power industry restructuring issues at the wholesale and retail levels.³ The FTC staff also contributed (as did FERC staff) to the work of the Electric Energy Market Competition Task Force, which issued a *Report to Congress* in 2007.⁴ In addition, the FTC held public conferences on energy topics, including *Energy Markets in the 21st*

² See, e.g., Opening Remarks at the FTC Conference on *Energy Markets in the 21st Century: Competition Policy in Perspective* (Apr. 10, 2007), available at <http://www.ftc.gov/speeches/majoras/070410energyconferencereemarks.pdf>. FTC merger cases involving electric power markets have included the *DTE Energy/MCN Energy* (2001) (consent order), available at <http://www.ftc.gov/os/2001/05/dtemcndo.pdf>; and *PacifiCorp/Peabody Holding* (1998) (consent agreement), available at <http://www.ftc.gov/os/1998/02/9710091.agr.htm>. (The FTC subsequently withdrew the *PacifiCorp* settlement when the seller accepted an alternative acquisition offer that did not pose a threat to competition.)

³ FTC Staff Report, *Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform: Focus on Retail Competition* (Sept. 2001), available at <http://www.ftc.gov/reports/elec/electricityreport.pdf>; FTC Staff Report, *Competition and Consumer Protection Perspective on Electric Power Regulatory Reform* (July 2000), available at <http://www.ftc.gov/be/v000009.htm> (compiling previous comments from the FTC staff provided to various state and federal agencies).

⁴ See <http://www.ferc.gov/legal/fed-sta/ene-pol-act/epact-final-rpt.pdf>.

Century (April 10-12, 2007)⁵ and *Carbon Offsets & Renewable Energy Certificates* (January 8, 2008).⁶

The FTC and its staff have filed numerous competition advocacy comments with FERC and participated in FERC technical conferences on market power issues. On December 3, 2009, the FTC submitted a reply comment on Transmission Planning Under Order No. 890 (Docket No. AD98-8-000).⁷ Also in December 2009, the FTC submitted a comment in FERC's proceedings on possible elements of a National Action Plan on Demand Response (Docket No. AD09-10-000).⁸ Other FTC participation in FERC's competition-related inquiries has included the March 2007 appearance by the Deputy Director for Antitrust in the FTC's Bureau of Economics as a panelist for a technical conference on FERC's merger and acquisition review standards under Federal Power Act (FPA) Section 203 (Docket No. AD07-2-000). The FTC also has commented on FERC's initiatives to promote wholesale electricity competition and on various state issues associated with restructuring the electric power industry.⁹

Efficient Compensation for Demand Response

The use of efficient compensation levels for demand response will elicit efficient levels of demand response. As explained in the FTC's May 13, 2010, filing in this docket, the efficient price level for demand response compensation requires that (1) LMPs internalize the external social costs of electricity consumption, (2) demand response compensation be set at a level equal

⁵ Conference materials available at <http://www.ftc.gov/bcp/workshops/energymarkets/index.shtml>.

⁶ Conference materials available at <http://www.ftc.gov/bcp/workshops/carbonoffsets/index.shtml>. Other programs have included the FTC's public workshop on *Market Power and Consumer Protection Issues Involved with Encouraging Competition in the U.S. Electric Industry*, held on September 13-14, 1999 (workshop materials available at <http://www.ftc.gov/bcp/elecworks/index.shtml>); and the Department of Justice and FTC workshop on *Electricity Policy*, held on April 23, 1996.

⁷ Reply Comment of the Federal Trade Commission, Transmission Planning Processes Under Order No. 890, Docket No. AD09-8-000 (Dec. 3, 2009), available at <http://www.ftc.gov/os/2009/12/V100001ferc.pdf>.

⁸ This comment is available at <http://www.ftc.gov/os/2009/12/V100002ferc.pdf>.

⁹ See, e.g., Federal Trade Commission, Comment before the Federal Energy Regulatory Commission on Wholesale Competition in Regions with Organized Electric Markets (Apr. 17, 2008), available at <http://www.ftc.gov/be/v070014b.pdf>. A listing of FTC and FTC staff competition advocacy comments to federal and state regulatory agencies (in reverse chronological order) is available at http://www.ftc.gov/opp/advocacy_date.shtml.

to LMP, and (3) a demand response provider buy the power that it resells as demand response from its load-serving entity using its usual rate.¹⁰ Compensating demand response providers at this price will give them incentives to provide demand response only when it is efficient for them to do so.

The Consequences of Using Inefficient Prices To Compensate Demand Response Providers

The proposal to implement a net benefits test to determine the periods in which to compensate demand response providers arises as a policy issue only if the compensation level has been set above the efficient level (*i.e.*, if that compensation equals LMP without requiring the demand response provider to purchase the power that it resells).¹¹ If the compensation level has been set too high, demand response will be excessive, with the result that the costs of such compensation will exceed the benefits in various time periods. Although a corrective measure (such as a net benefits test) may tend to reduce the welfare loss from setting an excessive compensation level for demand response, inefficiencies will remain so long as inefficient prices are the basis for compensating demand response providers. For example, these efficiency problems are likely to persist in any period in which a net benefits test yields positive results when demand response is paid LMP minus the flat retail rate but negative results when demand response is paid the full LMP.

The Supplemental NOPR cites public comments that support full LMP as the compensation level for demand response and also support a net benefits test. Those comments implicitly recognize that the payment of full LMP constitutes overcompensation for demand response providers who pay flat retail rates.

¹⁰ Federal Trade Commission, Comment before the Federal Energy Regulatory Commission on Demand Response Compensation in Organized Wholesale Energy Markets (May 13, 2010), available at <http://www.ftc.gov/os/2010/05/100521fercdemand.pdf>.

¹¹ Whether to adopt a net benefits test – the question that we address here – is an issue separate from whether LMPs internalize the external social costs of electricity consumption.

Remedying Insufficient Compensation of Demand Response Providers

We recognize that it may be tempting to use an excessive demand response compensation formula to make up for LMPs that are themselves insufficient (because they do not incorporate all of the relevant social costs). Such a patchwork approach, however, is likely to create its own inefficiencies. The problem arises because the situations in which excessive demand response compensation (full LMP) applies will not coincide with the situations in which demand response compensation is inadequate. A plan to inflate the formula for demand response payments to offset insufficient LMPs is very likely to miss the efficient result and instead produce a hodgepodge of over- and under-compensation for demand response.

We encourage FERC to adopt efficient pricing for demand response compensation and thereby avoid the need to devise administrative means (*e.g.*, a net benefits test) to trim the excess demand response that is likely to stem from FERC's proposed use of an excessive compensation formula.¹² Efficient prices create incentives that lead to efficient outcomes. Nonetheless, we recognize the complexity of the issues with which FERC must grapple. If FERC ultimately decides to adopt full LMP pricing and fashion a net benefits test, we look forward to the possibility of commenting on any specific proposals that FERC may announce.

¹² The use of our recommended demand response compensation standard – LMP minus the retail price of power – will not prevent FERC from fostering its goal of increasing demand response. The application of that standard would still leave FERC with the flexibility to apply any additional incentives that it deems appropriate to achieve that objective.