
FERC Requires Market-Based Compensation for Demand Response Resources

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On March 15, 2011, the Federal Energy Regulatory Commission ("FERC") issued Order 745, which established a new approach for compensating demand response resources that participate in the nation's organized wholesale energy markets. In enacting the rule, FERC recognized that the Energy Policy Act of 2005 required the elimination of unnecessary barriers to the participation of demand response resources in the organized wholesale energy markets, and that those markets function most effectively when both supply and demand resources have appropriate opportunities to participate.

Under Order 745, the individual organized wholesale energy market operators—otherwise known as an Independent System Operator ("ISO") or Regional Transmission Organization ("RTO")—are required to pay demand response resources the market price for energy, known as the locational marginal price or "LMP," when a two-step test has been met: (1) the demand response resource has the capability to balance supply and demand as an alternative to a generation resource; and (2) the ISO or RTO dispatches the resource when it is cost-effective to do so.

With respect to this second requirement, FERC determined that it would

be cost-effective to pay the LMP to demand response resources when a "net benefits test" concludes that the benefit to electric customers from the reduced LMP that results from dispatching demand response resources exceeds the cost of paying LMP to those resources. Since this is a factual determination, FERC required each ISO and RTO to establish a net benefits test to determine when it is cost-effective to dispatch demand response resources in its organized wholesale energy market.

Order 745 requires each ISO and RTO to make a compliance filing, which is required to include conforming tariff provisions and identify price thresholds to estimate where net benefits to customers would occur, with FERC by July 22, 2011. In addition, each ISO and RTO is required to conduct a study that examines the requirements for and effects of directly determining the cost-effective dispatch of demand response resources in both the day-ahead and real-time energy markets, and to file the results of the study with FERC by September 21, 2012.