NO. 14-840, 14-841

# In the Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
*Petitioner*,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,
*Respondents*.

ENERNOC, INC., *et al.*,
*Petitioners*,

v.

ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,
*Respondents*.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

## BRIEF FOR RESPONDENTS MIDWEST LOAD-SERVING ENTITIES

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August 31, 2015

## CORPORATE DISCLOSURE STATEMENT

The following respondents join this brief and provide the following Rule 29.6 statement:

Missouri Joint Municipal Electric Utility Commission, Missouri River Energy Services, Southern Minnesota Municipal Power Agency, and WPPI Energy are not nongovernmental corporate parties, nor do any of them issue any stock, thus they are not subject to the corporate disclosure statement requirement.

Madison Gas and Electric Company is a public utility organized under the laws of the State of Wisconsin, and is the primary subsidiary of MGE Energy, Inc., an investor-owned public utility holding company headquartered in the state capital of Madison, Wisconsin. No publicly-held company owns ten percent or more of the stock of MGE Energy, Inc.

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## STATEMENT OF THE CASE

While this case is about the extent of the States' exclusive jurisdiction over retail sales of electricity, it is also about the myriad demand response programs at the retail level that have long been in place and that Congress directed FERC to encourage. These programs are important tools for utilities balancing their supply and demand, but are threatened by FERC's Order 745.[1] As load-serving entities—electric utilities that, directly or indirectly, have an obligation to serve retail customers (16 U.S.C. 824q(a))—respondents Midwest Load-Serving Entities (or Midwest LSEs) are concerned about the future of those programs and thus with the outcome of this case.

Midwest LSEs are filing this short response to offer their perspectives on this issue. To avoid unnecessary duplication, this brief does not repeat the relevant facts and procedural history described in the brief to be filed by the Electric Power Supply Association, American Public Power Association, and other respondents to this case.

Midwest LSEs are a group of small utilities in several Midwestern states.[2] One, Madison Gas and

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[1] Demand Response Compensation in Organized Wholesale Energy Markets, Order 745, 76 Fed. Reg. 16,658 (Mar. 24, 2011), FERC Stats. & Regs. ¶ 31,322 (2011) (Order 745) (Pet. App. 49a-172a), *clarified*, Order 745-A, 137 FERC ¶ 61,215 (2011) (Order 745-A) (Pet. App. 173a-275a), *reh'g denied*, Order No. 745-B, 138 FERC ¶ 61,148 (2012).

[2] Midwest LSEs participated in the proceedings before FERC and the court of appeals under the name "Midwest Transmission Dependent Utilities." They are "transmission dependent utilities" because they rely in whole or part on transmission over lines owned by other utilities, including lines

Electric Company, is an investor-owned electric utility. The other four are not-for-profit municipal joint action agencies, organized under the laws of their respective states by their members, which are municipally-owned electric utilities. Among other things, each of the municipal joint action agencies is under long-term contract to supply some or all of the electricity requirements of its members.

Midwest LSEs are all directly or (in the case of the municipal joint action agencies) indirectly responsible for providing electric service to retail customers—residential, commercial, and industrial—within a defined service territory. This means that they must generate or procure the power needed by their or their members' retail customers. In addition, they are responsible for ensuring that their electric system is operated safely and reliably, and that their customers are charged reasonable rates for that service.

Midwest LSEs serve a diverse set of customers and member utilities.

**Madison Gas and Electric Company** is a public utility organized under the laws of Wisconsin that provides service to residential, commercial, and industrial customers over approximately 250 square miles in and around the city of Madison. The area it serves has a population of approximately 309,000. Its 2014 peak load was 690 megawatts; it has 123,677 residential customer accounts and 19,510 commercial and industrial accounts.

**Missouri Joint Municipal Electric Utility Commission** is a joint action agency organized under Missouri law. Among other things, it operates

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under the control of one or more regional wholesale market operators or Regional Transmission Organizations (RTOs).

generation facilities and purchases and sells electric power for its sixty-seven municipal utility members, which together serve approximately 347,000 retail customers with a combined peak load of approximately 2,639 megawatts in 2014.

**Missouri River Energy Services** is a municipal joint action agency organized under Iowa law with sixty-one full-member and eighteen associate-member municipal utilities located in four states. Missouri River's members have approximately 144,510 customer accounts—120,340 of which are residential and 24,170 of which are commercial and industrial—and serve a population of about 273,900. The 2015 peak demand of Missouri River's members was 895 megawatts.

**Southern Minnesota Municipal Power Agency** is a joint action agency organized under Minnesota law with eighteen member municipalities with a combined peak load of 506 megawatts in 2014. Its members serve over 99,800 residential customers and over 12,600 commercial and industrial customers.

**WPPI Energy** is a municipal electric company organized under Wisconsin law with fifty municipal members and one cooperative. It supplies the bulk power and energy requirements of its members from generation resources that it owns, as well as through purchased power contracts, with a 2014 peak of 959 megawatts. Through WPPI Energy, its members provide reliable, affordable electricity to about 174,000 residential customer accounts and 27,000 commercial and industrial accounts, serving a population of approximately 345,000.

## SUMMARY OF ARGUMENT

Midwest LSEs are filing this brief—and participated in the underlying proceedings—because they have long found retail-level demand response programs to be a valuable tool in meeting their obligations to provide affordable, reliable electric service to retail customers. Contrary to Congress's directives to FERC to foster such programs, Order 745 threatens their existence.

FERC's construct in Order 745 transmutes an individual retail customer's decision *not* to buy an existing product—i.e., electric energy—into a new "product" that the customer can sell on the supply side of the wholesale energy market. By then requiring wholesale market operators to overcompensate that demand response, FERC's Order 745 creates a financial incentive for retail customers to bypass existing demand response programs at the retail level in order to receive that excessive wholesale market compensation.

As a result, load-serving entities, like Midwest LSEs, must procure power supplies for retail customers that may then choose to bid their reduced electricity consumption into the supply side of the wholesale market, rendering that costly procurement unnecessary. And while the individual retail customer that bids its non-consumption into the wholesale market will benefit financially, the rates of its utility's other retail customers would likely be much higher than they would have been if the same demand response had been implemented through a demand response program at the retail level.

Midwest LSEs agree with the arguments made in the brief of respondents Electric Power Supply Association, American Public Power

Association,[3] *et al.* This brief does not reiterate each argument in that brief, nor does it argue each legal issue in the case. Instead, Midwest LSEs provide the Court with a brief summary of how they use demand response programs at the retail level—and the benefits of those programs—and explain how overcompensation of demand response in wholesale energy markets, as FERC mandated in Order 745, improperly undermines those retail-level demand response programs that Congress directed FERC to encourage. For these reasons, as well as those provided in the principal respondent brief, this Court should affirm the judgment of the United States Court of Appeals for the District of Columbia Circuit in its entirety.

## ARGUMENT

As load-serving entities, every member of Midwest LSEs has an obligation to provide reliable, reasonably priced electric service. They are filing this brief—and participated below—because they have long found demand response programs operated through retail utilities to be a valuable tool in meeting those obligations.

Contrary to the California Public Utilities Commission's suggestion that opponents of Order 745 seek merely to eliminate competition and "magnif[y] the profit increases available to generators" (Br. 15), Midwest LSEs have other motivations in opposing Order 745. Midwest LSEs—like other load-serving entities—generally do not benefit from higher wholesale energy prices. In fact,

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[3] Most of the Midwest LSEs are members of the American Public Power Association.

they have strongly supported robust competition in the wholesale markets. Likewise, contrary to the suggestions of *amici* Electricity Consumers and Demand Response Providers (Br. 12), Midwest LSEs are incentivized by State regulators or their municipal members to minimize costs to consumers; they cannot be "indifferent" to wholesale prices.

Midwest LSEs are concerned that FERC's demand response compensation scheme arbitrarily and capriciously disrupts retail-level demand response programs, and distorts existing market structures in a way that will compromise their ability to use demand response to serve retail customers in a cost-effective and reliable manner.

## I. ROBUST DEMAND RESPONSE PROGRAMS AT THE RETAIL LEVEL ARE EFFECTIVE AND SHOULD BE PRESERVED

Demand response programs at the retail level have for years served as a cost-effective and reliable way for load-serving entities to meet customer needs, and do not rely on FERC authority or Order 745's supply-side demand response construct for effectiveness. These programs allow load-serving entities to decrease their demand from retail customers under a variety of circumstances.

Some retail customers give their utility the right to interrupt a portion of their load in exchange for a credit on their bill or a different rate schedule.[4] For example, Madison Gas and Electric has had demand response programs at the retail level in place under the direction of its state regulatory

[4] Some municipal utilities execute these programs in partnership with the municipal joint action agencies that supply their bulk power and energy requirements.

commission, the Public Service Commission of Wisconsin, since 1984. J.A. 929. Approximately twenty-five megawatts of its commercial and industrial load are under an interruptible schedule where retail customers receive a reduction on their demand charges year-round in exchange for giving the utility the right to interrupt them in specified conditions. Similarly, another twenty-five megawatts of residential air conditioning load (belonging to approximately 16,000 residential customers) are subject to Madison Gas and Electric's control. *Id.* Those retail customers receive compensation in exchange for allowing Madison Gas and Electric to interrupt their loads. *Id.*

Other Midwest LSEs have similar programs.[5] For example, Missouri River Energy Services offers a coordinated demand response program at the retail level to its member utilities, which focuses first on arrangements that give Missouri River and its members direct control over air conditioners, electric water heaters, and electric heat. Under that program, a member utility's retail load can be monitored and remotely managed by the member and Missouri River.[6]

These programs deliver real benefits. In addition to providing participating customers fair compensation, they allow the load-serving entity to

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[5] Post-Technical Conference Comments of Midwest TDUs 6 n.14, *Demand Response Comp. in Organized Wholesale Energy Mkts.*, Docket No. RM10-17-000 (Oct. 13, 2010), eLibrary No. 20101013-5117, http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=12461521.

[6] Bright Energy Sols., *Coordinated Demand Response*, http://www.brightenergysolutions.com/informationcenter/coordinateddemandresponse/ (last visited Aug. 27, 2015).

limit the generation it builds or procures, lowering its costs for capacity. By doing so, the programs reduce electric rates for the entire customer base of the utilities that use them. These programs also reduce overall energy costs by limiting the need to make purchases from the market when energy prices are high, while also allowing the participating retail customer to lower its own bill. Because the load-serving entity controls the load directly, it can count on that reduction whenever it is needed, and can likewise count on it being available at a predictable price.[7] All these features provide substantial value to the load-serving entity and its customer base.

Other demand response programs at the retail level rely on the load-serving entity requesting that customers lower their consumption in response to certain system conditions, or structure prices so that customers may have incentives to drop load when useful to the utility. While these types of demand response programs may not provide direct control

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[7] These types of traditional demand response programs at the retail level have a much higher response rate than price-driven "economic" demand response:

> The 2007 FERC Staff Assessment of Demand Response and Advanced Metering (at 7) found load reductions in demand bidding programs of only 4-19% of enrolled demand response resources, and FERC's 2007 report distinguished between "economic" (demand bidding) [demand response] (which is not as effective, *i.e.*, <20% response rate) and "reliability-based" [demand response] (which has a much higher response rate—62% and 83% in the programs reported in the 2007 Staff Assessment). *Available at* http://www.ferc.gov/legal/staff-reports/09-07-demand-response.pdf.

J.A. 930 n.3.

over retail customer load, the load-serving entity can structure its program and prices to achieve its specific load-reduction targets with a reasonable degree of predictability. In addition, in some cases the program may require that retail customers choosing to use the program provide advance notice to the utility, so that their expected lower demand can be taken into account in the utility's wholesale market demand bids. Like directly controlled curtailable load programs, these programs allow the load-serving entity to reduce its market purchases when prices are high (saving money for all customers), and provide direct savings to participating retail customers.

Demand response programs at the retail level have long been a crucial part of how load-serving entities like Midwest LSEs have served their customers, met demand on their systems, and increased the reliability of their service at times of peak demand, while reducing capacity and energy costs. These programs also reduce the clearing price in wholesale energy markets by reducing the demand (or load) side of the equation—just as other changes in retail rates and sales inevitably affect the clearing price in wholesale markets. Thus, contrary to the suggestion of Private Petitioners—who seem to argue that, like the sound of one hand clapping, only changes to supply can meaningfully affect wholesale market clearing prices (Br. 40)—load-serving entity demand response programs at the retail level *do* affect the market clearing price, but they do so as demand, not supply.

In contrast to sales by retail customers of demand response in wholesale energy markets under FERC's Order 745, no special adjustments to wholesale market structures are needed to

accommodate demand response programs at the retail level. Under Order 745, demand response creates an imbalance between wholesale supply (which now includes both real generation, plus sales of retail customer non-consumption) and metered wholesale demand. As a result, an adder to the wholesale energy market clearing price is needed to cover the payments that the wholesale market operator must make to generators and accepted demand response bidders (what FERC euphemistically refers to as the "billing unit effect"). Pet. App. 55a-56a, 92a-93a; Pet. App. 229a-230a; FERC Pet. Br. 50.

Retail-level demand response programs avoid this complexity. Those programs do not require wholesale market operators to administratively set hypothetical "normal" consumption levels in order to quantify the amount of demand response associated with each retail customer. And because retail customer "non-consumption" is not shifted to the supply side of wholesale energy markets, no adder to the wholesale energy market clearing price is needed to make the wholesale market operator's books balance. Instead, any decreases in consumption resulting from demand response programs at the retail level are automatically reflected in the load-serving entity's aggregate metered wholesale demand; and wholesale energy markets can clear where supply equals demand, without additional surcharges.

FERC's assertion (Br. 29) that it *must* have the authority to regulate demand response as a supply-side resource because there would otherwise be a "regulatory gap" is unfounded. Any "regulatory gap" is one FERC itself created in Order 745 by improperly transforming a retail customer's decision

not to consume electricity into a product sold on the supply side of wholesale energy markets. In addition, no one in this proceeding has argued that FERC lacks regulatory authority over *wholesale customer* demand response. Indeed, in a recent dissent, Commissioner Clark specifically argued that FERC "should explore ways to transition demand response from the supply-side to the demand-side where it properly belongs."[8]

Affirming the D.C. Circuit decision would not leave demand response "entirely unregulated" (FERC Pet. Br. 29). To the contrary, properly treating demand response as part of demand, not supply, would give both FERC and the States authority over demand response in their respective spheres.

## II. LOAD-SERVING ENTITIES BEAR THE REAL COSTS OF FERC'S ERRONEOUS RULE

By paying retail customers the full locational marginal price (LMP) for demand response, FERC is encouraging retail customers to sell their demand reductions on the supply side of wholesale energy markets rather than participating in demand response programs at the retail level as they have historically done. When they do, the utilities that

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[8] *PJM Interconnection, L.L.C.*, 150 FERC ¶ 61,251, at 62,768 (2015) (Clark, Comm'r, dissenting from FERC's decision to reject, as premature, tariff modifications proposed by PJM to bring its capacity market into compliance with the D.C. Circuit's jurisdictional ruling in *EPSA v. FERC*, by reflecting demand response in lower bids by wholesale buyers, instead of treating that demand response as a supply-side resource).

serve those retail customers incur substantial costs for capacity as well as energy.

Retail customers selling their non-consumption of electricity into wholesale energy markets have the *option* to reduce demand when it is in their economic interest, not the *obligation* to do so when it would be most beneficial to its utility. Moreover, there is no coordination between those individual retail customers and the utility that is obligated to meet their demand. To the contrary, eligibility to receive demand response payments under Order 745 depends on maintaining the fiction that the retail customers' loads will be higher than they actually are when those customers' demand response has been deployed.

As a result, under Order 745, every utility must design its system and procure resources to serve each retail customer's "normal" load at all times (consistent with its obligations as a load-serving entity), incurring costs for generation capacity that will turn out to have been unnecessary whenever the customer chooses to submit a demand response bid into the wholesale energy market and that bid is accepted.[9] Efficiencies and cost savings that might have been gained from demand response programs at the retail level are lost.

Load-serving entities will also pay more for energy, since Order 745 requires wholesale market operators to impose a surcharge, on top of the wholesale market clearing price for energy, in order

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[9] Unlike in PJM's "option to purchase" analogy (Br. 7-8, 23), the retail customer that makes an "election to reduce consumption" by selling its demand response into wholesale energy markets does not bear the cost of the option, but rather shifts costs to its utility and its utility's other customers.

to pay retail customers selling into the supply side of wholesale energy markets.[10] Nor does FERC's "net benefits test" compensate for this loss. The net benefits test is intended to assure that the overall wholesale bill of a retail utility is not larger than it would have been if *no* demand response had been deployed. Pet. App. 55a-57a, 94a-95a. However, wholesale bills to load-serving entities under that methodology—which could include a hefty surcharge to cover the shortfall created by FERC-mandated full-LMP payments to demand response bidders in the wholesale energy market—will likely be much higher than they would have been if the same demand response had been implemented through the load-serving entity's retail-level demand response programs. J.A. 936-937.

Even assuming FERC has authority to regulate retail sales as it has attempted to do in Order 745, the compensation paid to retail customers for demand response bid into wholesale energy markets should not undermine existing retail-level demand response programs. Those programs are integrated with the power supply planning of load-serving entities and designed to provide benefits to all of their customers. J.A. 934.

Unfortunately, as noted above, the compensation system created by Order 745 does exactly that. As explained in the brief of respondents Electric Power Supply Association, American Public Power Association, *et al.*, being filed simultaneously with this brief, FERC's full-LMP payment

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[10] As discussed above (at 10), this surcharge is needed because of what FERC calls the "billing unit effect"—i.e., the need for wholesale market operators to pay for more units of energy and demand response than there are units of metered load.

requirement mandates a subsidy that overcompensates retail customers in wholesale energy markets, providing them with compensation equal to the sum of the retail rate saved, plus the wholesale LMP.[11] This subsidy lures retail customers to sell their demand response in wholesale energy markets (see Pet. App. 11a), hollowing out demand response programs at the retail level and leaving retail utilities with less flexible load. FERC has provided no adequate justification for requiring that wholesale market operators compensate those retail customers at a level that is greater than the wholesale market price, particularly where that overcompensation damages existing retail-level demand response programs. Nor is this defect cured by the ability of State and local legislators to bar retail customers from participating in FERC's program.

Order 745's cost allocation methodology likewise crowds out existing demand response programs at the retail level. Under Order 745, customers of a utility with a robust retail-level demand response program could be required to pay for both: (1) 100% of the cost of those programs, plus (2) a share of the full-LMP payments made by the wholesale market operator for demand response sales by individual retail customers. This creates a financial disincentive for retail utilities to continue offering demand response programs at the retail level that are efficient and cost-effective.

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[11] Even Dr. Alfred Kahn, the economist cited in the rule and in petitioners' briefs (FERC Pet. Br. 48-49; Private Pet. Br. 11, 18, 47-48) as supporting the full-LMP mandate, did not disagree that demand responders would likely receive total compensation well in excess of LMP under the rule's approach. J.A. 1340-1343.

Thus, Order 745 undermines and supplants existing retail-level demand response programs. This outcome is contrary to FERC's stated intent not to interfere with existing demand response programs.[12] It also conflicts with Congress's directives in Section 1252(e) of the Energy Policy Act of 2005, which provides, "[i]t is the policy of the United States to encourage States to coordinate, on a regional basis, State energy policies to provide reliable and affordable demand response services to the public." 16 U.S.C. 2642 note. As well, it conflicts with Section 571 of the Energy Independence and Security Act of 2007, which directs the Commission to prepare, and to propose implementation measures for a National Action Plan for Demand Response that includes "[i]dentification of requirements for technical assistance to *States* to allow *them* to maximize the amount of demand response resources that can be developed and deployed." 42 U.S.C. 8279(b)(1) (emphasis added).

In addition, Order 745 moves wholesale energy markets further away from a competitive market structure in which clearing prices are the

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[12] Wholesale Competition in Regions with Organized Electric Markets, Order 719-A, 74 Fed. Reg. 37,776, 37,786 (July 29, 2009), FERC Stats. & Regs. ¶ 31,292, P 67 (2009), *on reh'g*, Order 719-B, 129 FERC ¶ 61,252 (2009):

> The intent of the Final Rule is not to interfere with, undermine, or change existing demand response programs. Nothing in the Final Rule would require a state or local regulator to take any action or prevent them from: (1) preserving existing aggregation programs, in whatever fashion is appropriate for its jurisdictional area; or (2) authorizing retail customers, via an ARC, to participate in wholesale markets.

product of observed demand and observed supply, toward an administrative price-setting structure in which the wholesale market operator's projections of "normal" retail customer consumption become the baseline upon which payments are made and energy prices are established.

FERC has not adequately supported this departure from precedent or subversion of its stated aims and Congress's instructions. And the costs of Order 745 to load-serving entities like Midwest LSEs, as well as to their customers, are significant. FERC's demand response construct should not stand.

## CONCLUSION

For the reasons stated herein, this Court should affirm the judgment of the United States Court of Appeals for the District of Columbia Circuit in its entirety.

Respectfully submitted,

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