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High Court Ruling May Mean More Demand Response Scrutiny

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Wholesale demand response is alive and well. So said the U.S. Supreme Court in Federal Energy Regulatory Commission v. Electric Power Supply Association,[1] which reversed a D.C. Circuit decision[2] finding that the Federal Energy Regulatory Commission did not have jurisdiction under the Federal Power Act to incorporate demand response into the organized wholesale electricity markets it regulates (i.e., the independent system operators and regional transmission organizations). The D.C. Circuit found that FERC could not regulate wholesale demand response — which involves grid operators paying end users for reductions in their electricity consumption as an alternative to paying for additional electricity generation — because it involves the actions of retail electricity customers, with the retail market being subject to the jurisdiction of the states, rather than FERC.

In EPSA, the Supreme Court found that wholesale demand response programs fall within FERC's FPA jurisdiction, meaning demand response providers can continue to sell load reductions into wholesale energy and capacity markets. These markets can be lucrative for demand response providers since, under FERC policy, load reductions are generally paid at the same per-megawatt rate as wholesale electricity sales from generators, while demand response providers' costs are generally much lower than generators' costs. EPSA, therefore, is good news for the demand response industry.

Some less good news for wholesale demand response providers is that, with the cloud of jurisdictional uncertainty removed, FERC is likely to resume aggressively scrutinizing wholesale demand response activities, and whether those activities comply with FERC's regulations and the applicable wholesale market rules. Demand response providers — be they load-reducing end users or the "aggregators" who compile and offer load reductions into the wholesale market — should be aware of FERC's history of enforcement actions involving demand response practices and consider reviewing compliance practices to reduce the likelihood of landing on FERC's radar.

FERC's Prior Scrutiny of Demand Response Activities

Prior to the D.C. Circuit's May 2014 decision finding that FERC did not have jurisdiction over wholesale demand response, FERC's Office of Enforcement had aggressively targeted demand response practices it believed did not comply with applicable market rules or FERC's regulations (including FERC's prohibition of market manipulation and fraud, i.e., "the anti-manipulation rule"[3]). Below is a brief overview of FERC's prior enforcement actions involving demand response.

In October 2010, FERC approved a settlement agreement between the Office of Enforcement and North American Power Partners (NAPP) involving allegations that NAPP, a demand response aggregator in the PJM Interconnection market, violated PJM tariff provisions and the anti-manipulation rule by offering demand response resources into PJM's synchronized reserve market when the resources were unavailable to respond, failing to notify committed resources of events, and failing to submit compliance data to PJM following events. The Office of Enforcement also alleged that, with respect to PJM's capacity market, NAPP violated PJM tariff provisions and the anti-manipulation rule by submitting inaccurate registration data for resources, and registering resources before obtaining the necessary authorization. To resolve the matter, NAPP, without admitting liability, agreed to pay a civil penalty of $500,000 and to disgorge $2,258,127 plus interest in unjust profits.[4] In January 2012, FERC approved a separate settlement between the Office of Enforcement and a NAPP executive who was allegedly involved in the violations, in which the executive agreed to pay a $50,000 civil penalty and not participate in any PJM demand response activities for two years.[5]

In December 2012, FERC approved a settlement agreement between the Office of Enforcement and EnerNOC Inc. involving allegations that EnerNOC, a demand response aggregator, violated the ISO New England (ISO-NE) tariff by not exercising due diligence to prevent the submission to ISO-NE of inaccurate load data for certain EnerNOC demand response resources participating in ISO-NE's capacity market. To resolve the matter, EnerNOC agreed to pay a civil penalty of $820,000 and to disgorge $656,806 plus interest in unjust profits.[6]

In March 2013, FERC approved a settlement agreement between OE and Rumford Paper Company involving allegations that Rumford violated the anti-manipulation rule by engaging in fraudulent conduct in connection with its participation in an ISO-NE energy market demand response program known as the Day-Ahead Load Response Program (DALRP). The Office of Enforcement alleged that Rumford implemented a fraudulent scheme to defraud ISO-NE of demand response payments by curtailing its on-site generation during a five-day period when Rumford's initial baseline load was established instead of operating the on-site generator to supply Rumford with virtually all of its energy needs, as the Office of Enforcement claimed was typical for the facility during the time.

The Office of Enforcement claimed that these actions established an inflated baseline for future demand response activities and caused ISO-NE to pay more than $3 million for demand response that never occurred. To resolve the matter, Rumford, without admitting liability, agreed to a civil penalty of $10 million and to disgorge $2,836,419 in unjust profits — obligations the Office of Enforcement agreed Rumford, in light of its bankruptcy status, could satisfy through a single settlement payment of $3,036,419.[7]

In June 2013, FERC approved a settlement between the Office of Enforcement and Enerwise Global Technologies Inc. involving allegations that Enerwise, a demand response aggregator in PJM, violated the PJM tariff and the anti-manipulation rule in connection with its registration and the participation of the Maryland Stadium Authority in PJM's capacity market. The Office of Enforcement alleged that

Enerwise registered the stadium Authority for a load reduction amount it knew could not be achieved given certain operational limitations, having an engineer perform a one-time work-around so that the stadium authority could successfully perform a required PJM demand response test event, and instructing the stadium authority to increase its load prior to the test event by turning on stadium lighting and other equipment in order to portray a larger load reduction. To resolve the matter, Enerwise, without admitting liability, agreed to pay a civil penalty of $780,000 and to disgorge $20,726 plus interest in unjust profits.[8]

Finally, in August 2013, FERC assessed civil penalties against Competitive Energy Services LLC (CES), Richard Silkman, and Lincoln Paper & Tissue LLC in connection with the same or similar conduct in ISO-NE's DALRP at issue in the Rumford Paper Company settlement discussed above. FERC assessed civil penalties against CES and Silkman of $7.5 million and $1.25 million, respectively, and directed CES to disgorge $166,841 plus interest in unjust profits, in connection with CES and Silkman's role as an advisor to Rumford.[9] The Office of Enforcement claimed that CES, an independent energy services company, and its managing member, Silkman, violated the anti-manipulation rule by devising and, with Rumford, implementing a scheme to inflate Rumford's DALRP baseline.

CES and Silkman did not settle with the Office of Enforcement and refused to pay the assessed penalties, which are now subject to de novo review in litigation pending in federal district court in Massachusetts. Likewise, FERC assessed a civil penalty of $5 million against Lincoln Paper, and directed it to disgorge $379,016 plus interest in unjust profits, in connection with Lincoln Paper's participation in the DALRP.[10] FERC alleged that Lincoln Paper violated the anti-manipulation rule by engaging in similar conduct in connection with the DALRP, allegedly implementing a scheme to inflate its demand response baseline by curtailing its on-site generation during the baseline period, rather than operating its on-site generation as it normally did. Lincoln Paper also did not settle with the Office of Enforcement and has refused to pay the assessed penalties, which are also now the subject of pending litigation in federal district court in Massachusetts.

Potential Impact of EPSA on Enforcement Activities

While FERC never officially stated it was suspending or limiting enforcement scrutiny of demand response activities as a result of the D.C. Circuit decision, it appears that FERC took a more cautious or, at least, deliberate approach to demand response enforcement while its jurisdiction over demand response was uncertain. Since the D.C. Circuit issued its decision finding that demand response was not FERC-jurisdictional, FERC has not (1) approved any settlements involving demand response, (2) issued any notices of alleged violations involving demand response, or (3) issued any orders to show cause involving demand response.[11] Perhaps most indicative of a "wait and see" approach by FERC was its attempt to stay its pending enforcement actions in federal district court in Massachusetts against CES, Silkman and Lincoln Paper while it considered its appellate options following the D.C. Circuit's decision.[12]

With the jurisdictional uncertainty of wholesale demand response largely resolved, we would expect FERC to renew its focus on wholesale demand response activities, which will have both micro and macro effects. At the micro level, FERC will likely push forward with any demand response investigations that it may have held off initiating or advancing because of the jurisdictional uncertainty. The EPSA decision also enables FERC's pending enforcement actions against CES, Silkman and Lincoln Paper in federal district court to proceed. While the court did not formally stay those cases, the court deferred ruling on the defendants' motions to dismiss, which relied, in part, on the now-overturned D.C. Circuit decision holding FERC lacked jurisdiction over demand response. On Jan. 26, 2016, following FERC's notice to the

court of the EPSA decision, the court invited the parties to submit additional briefing on the implications of EPSA on those pending motions.[13]

At a macro level, FERC is likely to resume its scrutiny of demand response activities, relying on both old tools and new. FERC has historically relied on ISOs and RTOs, which administer wholesale demand response programs, and their market monitoring units, to bring potential violations and compliance issues to the Office of Enforcement's attention. This will likely continue. It is also worth noting, however, that the Office of Enforcement's internal surveillance capabilities have evolved significantly over the past few years as the Division of Analytics and Surveillance — created in 2012 — has grown and matured. Thus, it would not be surprising if OE also uses its internal surveillance capabilities to scrutinize demand response activities like it does other types of conduct in the electricity and natural gas markets.

Specific areas of enforcement scrutiny will likely continue to include issues relating to load reduction capabilities, data accuracy and baselines. Measuring demand response, which, by definition, involves measuring the amount of something that did not occur (i.e., foregone electricity consumption), has always been more difficult than measuring the megawatts produced by a generator. Therefore, FERC has sought to use its enforcement tools to make sure that the load reductions the wholesale markets pay for, in fact, occur. Because accurate baselines and data are key to determining load reductions, FERC is likely to continue its focus in these areas.

Proactive Compliance Measures

Companies involved in wholesale demand response markets should consider reviewing their compliance practices to see if there are opportunities to reduce compliance risks associated with demand response participation. Compliance considerations will necessarily be different depending on the nature of the company (i.e., whether it is in the demand response business, such as an aggregator, or provides demand response as a retail end user) and the demand response markets in which the company participates. Implementing compliance controls can not only reduce compliance risk, but also better position a company to defend itself before FERC in the event it ever becomes a subject of an investigation or enforcement action.

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[1] Nos. 14-840, 14-841 (U.S. Jan. 25, 2016).

[2] Electric Power Supply Association v. FERC, 753 F.3d 216 (D.C. Cir. 2014).

[3] 18 C.F.R. § 1c (2015).

[4] North American Power Partners, Order Approving Stipulation and Consent Agreement, 133 FERC ¶ 61,089 (2010).

[5] In re Joseph Polidoro, Order Approving Stipulation and Consent Agreement, 138 FERC ¶ 61,018 (2012).

[6] EnerNOC Inc., Order Approving Stipulation and Consent Agreement, 141 FERC ¶ 61,211 (2012). The settlement agreement also resolved unrelated allegations that Celerity Energy Partners San Diego LLC, a wholly owned subsidiary of EnerNOC, did not comply with certain FERC filing obligations.

[7] Rumford Paper Co., Order Approving Stipulation and Consent Agreement, 142 FERC ¶ 61,218 (2013).

[8] Enerwise Global Technologies Inc., Order Approving Stipulation and Consent Agreement, 143 FERC ¶ 61,218 (2013).

[9] Competitive Energy Services LLC, Order Assessing Civil Penalty, 144 FERC ¶ 61,163 (2013); In re Richard Silkman, Order Assessing Civil Penalty, 144 FERC ¶ 61,164 (2013).

[10] Lincoln Paper and Tissue LLC, Order Assessing Civil Penalty, 144 FERC ¶ 61,162 (2013).

[11] A staff notice of alleged violations is a public notice issued by FERC after the Office of Enforcement has provided an investigation subject with preliminary findings and the subject has had an opportunity to respond to those findings. An order to show cause is an order from the commission commencing a formal proceeding against an investigation subject.

[12] Motion for Temporary Stay of Proceedings and Notice of Supplemental Authority, FERC v. Silkman, No. 1:13-CV-13054-DPW (D. Mass. June 2, 2014); Motion for Temporary Stay of Proceedings and Notice of Supplemental Authority, FERC v. Lincoln Paper and Tissue LLC, No. 1:13-CV-13056-DPW (D. Mass June 2, 2014).

[13] FERC v. Silkman, No. 1:13-DF-13054-DPW (D. Mass. Jan. 26, 2016) (Electronic Order), ECF No. 58; FERC v. Lincoln Paper, No. 1:13-CV-13056-DPW (D. Mass. Jan. 26, 2016) (Electronic Order), ECF No. 74.

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