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Demand Response Programs Lower Electricity Costs, But Also Pose Risks

Many industrial manufacturers with the ability to control their electricity usage are now taking advantage of demand response programs to help reduce their energy costs. Demand response programs pay participants to reduce electric energy usage for short periods of time. A decade ago most demand response programs were available only through local electric utilities, but this niche market has opened to commercial companies, which have introduced innovative program options and tools to help their industrial customers manage their real-time energy consumption.

Benefits of Demand Response Programs

Industrial manufacturers interested in participating in demand response programs can choose from a variety of options. For instance, one type of program pays a participant (typically a fixed fee) to be available to reduce electric consumption upon request, during electric generation capacity shortages or other emergency conditions impacting electric grid reliability. The manufacturer is paid whether or not a request to curtail electric consumption is ever made. Another type of program enables manufacturers to sell blocks of energy based on a reduction of their typical electricity consumption level. This program allows a participant to offer to sell “negawatts” akin to a sell-limit order placed on a stock. If the offer clears the power market, the participant curtails electric consumption at the time and for the duration specified by its offer. Energy curtailment responses might include adjustments to lighting and building temperatures, shifting work to a different time, shutting down idle equipment, or activating back-up generation.

While the amount of savings realized varies based on the demand response program in which manufacturers enroll, electricity consumption, and electricity prices, participants can realize overall savings up to 15% on their electricity bill. In addition to costs savings, demand response programs can be an effective tool to help improve management of a facility's operating costs and can help managers to better understand their facilities' electric energy requirements—critical information when preparing emergency management plans.

But the benefits these programs offer must be weighed against the compliance risks for industrial manufacturers.

FERC Steps Up Investigations into Demand Response Programs

The Federal Energy Regulatory Commission (FERC) regulates demand response programs as they relate to wholesale interstate power markets. (Please note that participation in some demand response programs may be regulated by state utility commissions charged with oversight of retail electric markets). Since 1935, the agency has regulated wholesale power transactions and, in that time, the rules and regulations have become increasingly complex, sometimes virtually indecipherable, to those not steeped in its jargon and practice.

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Compliance with FERC’s requirements is further complicated because no uniform rules and regulations applicable nationwide exist. Demand response rules therefore vary based on the tariffs of regional electric system operators that administer the programs. Rules and procedures may be clarified in the regional operators’ manuals, operating protocols, and other interpretive documents—or not at all.

Moreover, because demand response programs are designed and administered regionally, seemingly identical programs may be subject to completely different sets of rules and procedures in different areas of the country.

Compliance creates challenges because demand response program rules and requirements may change with little or no advance notice to the industrial manufacturer. The regional operators may radically change previously established program rules and requirements, or FERC itself may mandate changes. Misunderstandings about new or changed program rules may be perpetuated because manufacturers participating in one of these programs typically enroll through a third-party demand response service provider that acts as a “middleman.” Manufacturers may have no direct contact with the regional operators and therefore must rely on their service provider’s representations and notifications. Unfortunately, if that service provider misinterprets the rules or provides wrong or out-of-date information about how the demand response program works, the manufacturer may still be liable and subject to stiff penalties.

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Further complicating matters, demand response programs commonly require industrial manufacturer to establish and maintain an estimate of typical electric energy usage, called a baseline. The industrial

manufacturer should have a clear understanding of the regional operator's rules and procedures that the demand response provider applies to establish its baseline. If an industrial manufacturer has concerns about the baseline methodology applied or the results established for its facility, letting these concerns persist creates a risk that FERC may subsequently determine that these issues raise a concern. Similarly, being unable to actually provide the amount of capacity it has committed to reduce during system emergencies, or not reporting changes to on-site generation capacity to its demand response provider, also create risks for the unwary industrial manufacturer.

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For example, in March 2013, FERC concluded a five-year investigation of a New England paper mill's allegedly fraudulent participation in a demand response program over a six-month period in 2007 and 2008. FERC's investigation concluded that Rumford Paper Company manipulated its baseline electric energy consumption levels and claimed 20 MW of “phantom” curtailment capability. From FERC's perspective, it did not matter that the alleged scheme was developed entirely by an independent energy consultant. Nor did it matter that the third-party service provider did not carefully vet Rumford's plan, provide program training, or assist Rumford in developing energy consumption reduction strategies. The third-party provider did, however, substantially benefit by Rumford's enrollment, collecting ten percent off the top of the demand response payments Rumford received. FERC's settlement with Rumford resulted in the paper mill agreeing to pay more than \$3 million, including civil penalties and disgorged demand response payments. (The civil penalty and disgorgement actually totaled more than \$12 million, but FERC permitted Rumford to pay a lesser amount since it was in Chapter 11 bankruptcy proceedings.)

To close, demand response programs are an excellent way for manufacturers to reduce electricity costs, enhance their standing as good corporate citizens and help better manage their operations. But to reduce risks, industrial manufacturers should do their homework and consider consulting with experienced outside counsel to ensure they have an effective compliance program in place.

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