

December 1, 2008

PJM Board of Managers
955 Jefferson Avenue
Norristown, PA 19403

Re: RPM Changes – Capacity Markets Evolution Committee

Dear Members of the PJM Board of Managers:

The Curtailment Service Providers listed below are PJM Members and are active participants in the PJM RPM market who have a number of concerns about proposed RPM changes. The RPM stakeholder process has been particularly frustrating for CSPs because the primary focus on FERC mandated changes has captured the focus of the vast majority of stakeholders. These issues are generally not a major concern for CSPs. As a small subset of the largest membership sector, CSPs have struggled to have their voice heard. Making matters worse, the dynamic of the CMEC meetings relegated the discrete concerns of CSPs to secondary priority, or were given no attention at all. Priority issues for CSPs, to the extent they received attention at all, became mere bargaining chips between other dominant sector interests, without any apparent concern to respect the issues of importance to minority stakeholders. As is evidenced in part by the failure of to the CMEC to produce a substantive work product, the process became a dysfunctional battle between competing dominant sector interests. We are very concerned that this flawed and rushed process prevented a resolution with balanced results and fails to present the Board with a full view of stakeholder interests.

The CSPs participated in the stakeholder process and offered substantial good faith changes that increase costs and risks for CSPs. We made these offers with the hope that our concerns for the future of Demand Response in PJM's Reliability plans would be addressed. Unfortunately our requests for preserving critical RPM features have been largely ignored by staff and other stakeholders. Moreover, PJM staff has made it clear that they will recommend filing substantial RPM changes even on issues where FERC has not mandated a response. These issues are of critical concern to CSPs. We must therefore appeal to the PJM Board to assure that our concerns are properly identified.

Background

CSPs believe that the RPM market structure is strongly biased toward generation supply to meet reliability needs. This is because the three year forward structure is expressly designed to minimize the risk and cost of new generation. This bias is perhaps unavoidable, but it must be balanced. For most existing Demand Response, and virtually all potential Demand Response participants, a three year forward commitment structure increases costs and risks because most participants can defer decisions until much closer to the delivery year and because any credit assurance required in a forward auction is simply added cost. Financial and operational risk is actually higher with a three year forward commitment because, unlike generation supply whose sole business is supply, DR participants have many other priorities that can change substantially

in a three year period. The RPM design accommodated this difference with the Interruptible Load for Reliability (ILR) mechanism. RPM also established other key features that facilitated customer's voluntary participation in reliability markets:

First – RPM allows aggregators (CSPs) to directly solicit customers for participation. CSPs and customers both benefit from this market based competitive solution.

Second – the ILR mechanism provides for a clear certain price for customers. Most retail customers are highly risk averse and simply cannot maintain the expertise to understand the complex wholesale Market. CSPs make it simple for retail customers and this simplicity is enhanced by eliminating uncertainty about the benefits of participation.

Third – The RPM mechanisms establish a value for Demand Response that is comparable to the cost of capacity. As a result customer can act decisively to reduce costs by supporting reliability when the grid needs support rather than attempting reduce its own capacity obligations by guessing when Peak Demand obligations might be established.

We note that the RPM treatment of Demand Response has resulted in substantial increase in Demand Response Resources (DRR) for reliability. There are more than 4000 MW of DRR between DR in the BRA and ILR in the current delivery year. This represents an increase of twice the historical Active Load Management amount. The amount of DRR cleared in the 2011-12 BRA is greater than the forecast ILR for that year and the amount of ILR is expected to be at least at current levels – barring substantial changes in rules.

Early in the stakeholder process, CSPs heard clear concern that penalty structures may not be sufficiently robust to assure that DRR resources would respond when needed. CSPs took the lead in developing more robust penalty proposals, including addition of a testing protocol. CSPs also heard concerns about the forecast for ILR being too low and offered several alternatives for a more robust forecast mechanism. CSPs believed that stronger penalties with more robust ILR forecasts addressed most significant concerns with DRR. Unfortunately, PJM staff, in an apparent drive to force short term DRR into the long term BRA market design, created the flawed “Adjustment Auction” mechanism.

CSP Concerns with RPM Proposals:

1. The Adjustment Auction mechanism is flawed. The Adjustment Auction purports to be a short term mechanism. It may be short term for supply but it is long term for DRR. Various proposals provide for “hold backs” but all suggest only one third or less of the hold back for the final auction. The PJM proposal reduces the final opportunity for participation (equivalent to the current ILR window) from the current 2000MW ILR forecast to a 1000 MW “Adjustment Auction”. For the Current 2008-09 delivery year, there was 2000MW of uncleared supply offered at prices less than the BRA clearing price. These features drastically undermine two key components of the current structure – price certainty and comparable value. A huge excess of supply in the final auction can only result in a very low clearing price bearing no relationship to prevailing capacity

prices in PJM. This Adjustment Auction will be an erratic and uncertain artifice that will do more to distort pricing in the capacity market than it will do to create a short lead time resource replacement for ILR. It is not a market design feature that CSPs can build a business around. The “Adjustment Auction” should be rejected.

2. The transition creates intolerable uncertainty for 2009-10. While the bulk of the proposed RPM changes address the 2012-13 Delivery Year and beyond, all three proposals introduce penalties and testing requirements for ILR and DR in the 2009-10 delivery year. ILR for 2009-10 must be certified by March 2 – weeks *before* PJM’s targeted decision date for a FERC ruling. CSPs are currently actively marketing to potential ILR customers for participation in 2009-10 with no prospective knowledge of the FERC ruling on these critical issues. This situation is patently unfair to CSPs and likely amounts to retroactive ratemaking since it proposes to impose new rules on services committed after the commitment date. While any filing that contains changes in penalties and testing requirements is potentially subject to revision by FERC, a great deal of confidence and certainty would be gained by a PJM filing that proposed implementation of such changes in the 2010-11 delivery year.

CSP Recommendations:

1. Use the existing ILR mechanism with a more robust forecast of projected ILR. CSPs acknowledge that ILR deliveries well in excess of forecast levels create a problem. However, unlimited growth of ILR is unlikely – even with no changes in ILR rules. First, more robust penalties will increase the risk for the many highly risk adverse customers. Second, as DRR provides an increased share of supply, the frequency of emergency events will increase, further discouraging expansion of DRR. CSPs offered several proposals for Forecast methods that would be likely to achieve short term supply results that would be comparable to both capacity costs and BRA results. One CSP recommendation is that the Forecast be simply the most recent ILR delivery amount. CSPs also believe that the “Adjustment Auction” simply exchanges one form of uncertainty for another while introducing unneeded complexity for little benefit. It should be scrapped.
2. PJM staff and stakeholders should work with CSPs toward other refinements that will more closely align ILR with the overall RPM framework, including refining ILR such that it will primarily serve as the market opportunity vehicle for new short lead time resources and that, where appropriate, demand side capacity will transition to DRR.
3. PJM staff and stakeholders should work with CSPs to refine other elements of Demand Response in RPM, including enhanced performance penalty provisions, demand resource testing protocols, and credit and collateral barriers to DRR participation.

CSPs appreciate the Board’s attention to this matter

Sincerely,

Barbara Scoglietti – Comverge
Bruce Campbell – EnergyConnect
Ken Schisler – EnerNOC
Dara Biltekoff – Energy Curtailment Specialists (ECS)
Mike Haugh – Integrys
Mike DeCarlo – Mid Atlantic Power Partners

cc: Terry Boston – PJM
Andy Ott - PJM