

March 27, 2009

PJM Interconnection LLC  
Board of Managers  
955 Jefferson Ave  
Norristown, PA 19403

Re: PJM Economic Demand Response Program

Dear Board Members:

As you know, PJM stakeholders have been attempting to reach consensus on the PJM Economic Demand Response program for well over a year. Demand Response participants have long considered that a key feature of the original mechanism that provided for compensation of DR activity at LMP when prices are high should remain in place at least until Demand Response is clearly well established. A reminder of recent history may be helpful. When discussion on this issue began in earnest in the fall of 2007, a number of stakeholders insisted that there were serious problems with measurement and verification methods (known as Customer Baseline or CBL) and that no discussion of restoration of the LMP payment mechanism could be considered until this measurement issue was resolved. Demand Response participants worked with other members to produce the now current CBL method that was agreed to at the March 2007 MC meeting and implemented on June 13, 2008. Participants recognized that these changes would increase the accuracy of the CBL determination and facilitate the settlement process but would add some cost for customer participation. It was hoped by some participants that the improvements in settlement processing would offset the added costs of verification. Unfortunately, only the costs of the CBL enhancements have been realized to date with the result that the CBL changes and the expiration of payment at LMP have combined to lead to reduction of DR activity rather than enhancing activity. Since March of last year stakeholders have attempted without success to reach agreement on the compensation issue.

At the last two meetings of the Markets and Reliability Committee, votes have been taken on five proposals, only one of which received a majority of the sector vote. No proposal received a 2/3 super-majority. The proposals were not offered for a vote at the Member's Committee, depriving the Board of the voting details that such a vote might have offered. As a result we are providing a summary of our concerns on this issue.

**MWhrs of Demand Response Activity have declined**

MWh activity in the Economic DR program declined in 2008 in spite of the fact that the number of hours where the LMP was higher than \$100/MWh in 2008 doubled from 2007 with 1488 hours in 2008 and 788 hours in 2007. Clearly there has been an impact from both expiration of compensation at LMP and increased administrative complexity for CBL rules.

- The number of MWhrs settled in the Economic program declined from 714,148 in 2007 to 452,222 in 2008 – a 37% decline.

- The value of settled MWh declined from \$48,034,000 in 2007 to \$27,087,000 in 2008 – a 43% decline.
- The number of sites has declined slightly while the number of MW registered has increased about 10% from 2944 to 3290.

### **Significant barriers to entry remain**

Demand Response remains a new and developing mechanism. The fact that basic CBL and settlement rules remain in discussion are indicative of this fact. The challenges of Curtailment Service providers in overcoming customer inertia, in communicating frequent rule changes and in simply developing enough activity to become profitable are significant.

- Demand Response must transact through regulated utility competitors in much the same way that generators had to obtain transmission service through vertically integrated utilities.
- A developing industry has frequent changes in rules and varying regional standards – increasing costs in ways that do not affect generators. Frequent rule changes impose barriers to DR because most growth comes from smaller customers who have high transaction costs per MW delivered. Each change is disruptive to both providers and end use customers. The situation is not unlike an EDC trying to explain to all of its retail customers changes in rates and billing practices several times per year – sometimes retroactively.

### **Recommendation**

The undersigned support the PJM ICC proposal. It has one key feature that none of the other proposals include. This key is that the mechanism for ending the payments at LMP is dependent on demand response activity. All of the other proposals simply throw money at a problem by allowing such payments and then arbitrarily ending them. Even an approach offered by FE and others at the March 18 MRC to phase out payments at LMP on a calendar basis is flawed because it made no reference to sustainable DR activity. The hard sunset provisions contained in the EDC and PJM proposals are arbitrary and themselves introduce barriers to entry related to uncertainty about renewal, as well as the legal and stakeholder costs of considering renewal.

Several proposals also lack provisions to allow customers using LMP rates to take advantage of payments at LMP. This is a key issue for many customers. The PJM ICC proposal properly addresses this.

We believe that the PJM ICC approach will lead to a predictable and sustainable Economic Demand Response program. It will engage all stakeholders in a process to facilitate sustainable Demand Response. Some participants will be motivated because increased DR will help their bottom line. Some participants will be motivated to hasten an end to compensation at LMP because they believe that this mechanism is not sound market design.

The PJM ICC proposal unfortunately lacks specific metrics for measuring sustainable DR. We are confident that appropriate mechanisms can be identified and agreed upon by stakeholders – once the proposal is approved.

We also note that a number of Mid-Atlantic Commissions have endorsed essential elements of the PJM ICC proposal. We urge you, the PJM Board of Managers, to direct PJM staff to prepare a filing at FERC based on the PJM ICC proposal.

Thank you for your consideration,

Demand Response Participants

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