



November 29, 2010

Mr. Howard Schneider
Chair, PJM Board of Managers
PJM Interconnection, L.L.C.
995 Jefferson Avenue
Norristown, PA 19403

Dear Mr. Schneider:

I write on behalf of Hess Corporation regarding the pending filing from PJM at FERC on the matter of DR Saturation. The Board has the benefit of the records of the stakeholder process as well as numerous ex parte communications provided as you face the challenge of deciding what, if anything should be done on the matter of Demand Response Saturation. We write endeavoring not to duplicate or belabor any positions already made, but rather seek to highlight what we believe are the critical components of this issue requiring Board input and direction. Focusing on what we see as the core issues we present both long and short term solutions to the issue identified by PJM.

Background of Analysis

At the heart of the debate is the starting point of the issue: the demand response saturation analysis itself ("Analysis"). The Analysis was conducted unilaterally by PJM Staff; they identified what they believed was a potential problem, performed an analysis with little to no stakeholder input on the methodology or assumptions used, and devised potential solutions. It was only at that point that stakeholder input was sought, which was to decide on the choice of pre-determined solutions. The minimal level of input and the expedited time-frame afforded limited opportunity for insight or input on the assumptions directly impacting the output of the Analysis. It also prevented incorporation of less drastic interim solutions such as the more efficient dispatch of demand side resources.

Concerns With Analysis

Impact on Customer Confidence

As stated by Andy Ott at the recent Member's Committee meeting on November 18th, PJM has experienced very good demand side resource performance during emergency conditions, even outside of the current compliance window. As a stakeholder body, we should strive to not needlessly or prematurely disrupt that beneficial momentum provided by demand side capacity resources by seeking to implement inadequately studied solutions. Our concern is that the Analysis itself, the lack of transparency surrounding it, the perceived urgency it belies, and its dismissal of potential interim solutions, can create a disruption for the market and most importantly for the customers who participate.

PJM has been at the forefront of market design, not the least of which is its demand response program. The success of this program, measured by both the reliability benefits it has

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provided as well as the customer support it has engendered, is at risk if actions are taken based upon this rushed and limited Analysis. The changes considered throughout review of the Analysis are all significant departures from the existing program and customer expectations. Acting now to implement these major changes (i.e. caps and product changes) can result in potentially irreversible effects on the customer confidence and willingness to participate in this program. The potential of such long lasting effects mandates that greater consideration be given to the process by which we arrive at the solutions to be implemented.

The Analysis and assumptions it relied upon, unilaterally determined and performed, is critical not just because it calculates the level at which saturation occurs for the traditional 10x6 product, but because it directly triggers, assumes and pre-supposes the solutions and the time frame in which to address the issue. While the expertise of the PJM Staff is unsurpassed, given the magnitude of the issue and the ramifications of solutions on the market as a whole, it is critical to engender transparency and broad input into the Analysis. We do not dispute the reality that a “saturation level” exists, or that measures must be taken to ensure reliability. However, we believe it is critical to revisit the Analysis itself prior to implementing major market changes and limitations, which will have rippling and potentially irreversible effects on the robust and successful and load management program PJM, its stakeholders, and consumers have created.

Consistency

The assumptions and transparency of the Analysis are critical not just because they are the vehicle by which immediate changes are sought (to be implemented for the upcoming 14/15 BRA), but because it will be relied upon for future years. It is our understanding that the Analysis will be utilized every year and incorporated into the planning parameters used for each annual BRA. Therefore it will play a key role in dictating the amount and form of Demand Response deemed acceptable on PJM, which will in turn have significant economic impacts on the market, businesses, and end use consumers. Given these significant ramifications, it is essential that the Analysis be specific, clear, and reproducible from the outset, as well as memorialized in a Tariff or Manual. It is critical that market participants have confidence that they can rely upon the accuracy and reproducibility of the Analysis results on a yearly basis.

Contradictions to Market Design Assumptions

Equally important to the need for greater transparency in the saturation Analysis is that the solutions currently under consideration introduce concepts rejected as part of the RPM concept implemented on PJM. Specifically the concept of compensating capacity resources based on “quality” or physical attributes. One of the beauties of the RPM construct is that it recognizes the need for, and relies upon a diverse portfolio of capacity resources. All resources have distinct qualities and limitations and that diversity is necessary to maintain a reliable system. The recognition that all classes of resources are different but necessary, contributed to the differentiation in price only being driven by geographical constraints. The solutions arising from the Analysis has introduced a departure from that premise; i.e. differentiation in price based upon “quality” or attributes of the capacity resource as opposed to simply system geographical constraints. This significant shift itself warrants broader consideration of the Analysis and its underlying assumptions given that it is directly contrary to the RPM market design.

Recommendation

Therefore we propose the Board direct the Analysis itself be revisited and directed back to the stakeholder process. We believe it is important to incorporate not just PJM and

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Stakeholder input on the assumptions used for the Analysis, but to also call upon the expertise of external resources to contribute to the development of a more transparent Analysis. This is a common practice in other major market issues, such as the currently underway review of Load Forecasting, and would provide neutral perspective on what is clearly an important and hotly contested matter. Upon completion of analyzing and re-working the Analysis, it is at that point that the stakeholders should address long term solutions to manage the implications posed by the saturation of demand side capacity resources.

Interim Measures

We recognize however, in spite of the uncertainty surrounding the Analysis itself, that PJM has expressed concerns over the potential reliability implications posed by Demand Response Saturation. It is certainly not our intent to tie PJM's hands on its ability to address what it sees as a reliability concern while the Analysis itself is revisited and more fully vetted in the stakeholder process before permanent solutions are determined. Therefore if PJM believes it is important to impose a cap on the current demand response capacity resource (the 10x6 product), we believe an appropriate solution for 14/15 is to implement a cap no less than the maximum amount that PJM has already accepted of that resource. Again, as expressed by PJM itself, Demand Response in its current form has performed more than it has been required, and we see no reason to reduce or disrupt that reliable resource PJM has been able to call upon with success. It is critical that this solution aggregates the total DR and ILR that has cleared and registered in any one delivery year up to this point. This is essential because while the amount of Demand Resources clearing in RPM has increased, the elimination of ILR will reduce the total amount of demand side capacity resources available to PJM. Therefore the interim saturation level should be established by the maximum amount of demand side resources PJM has had the benefit of, regardless of whether cleared in RPM, or registered as ILR. Additionally it is very important that PJM incorporate a more efficient dispatch of the demand resources available to it. This should be considered and sought to be factored into PJM dispatch as quickly as possible, and be incorporated into the Analysis itself. Finally, we suggest that no changes be made to the treatment of the 2.5% holdback for the 14/15 BRA. As articulately set forth in the ex parte communications from the Illinois Commerce Commission and the Curtailment Service Providers group on this issue, this singular change would have significant economic implications. More consideration by the stakeholder body should be given to this issue before any changes are made.

Thank you for your consideration of our thoughts on this matter. The magnitude of the issue before you is great and far reaching, and we appreciate you affording the issue the due consideration it deserves.

Sincerely,

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