

March 25, 2011

Via Electronic Mail

Mr. Howard Schneider
Chair, Board of Managers
The PJM Board of Managers
PJM Interconnection, L.L.C.
955 Jefferson Avenue
Norristown, Pennsylvania 19403-2497

Re: Implementing Price Responsive Demand in PJM

Dear Mr. Schneider and Members of the PJM Board:

The undersigned Members of the PJM Supplier Caucus have reviewed the latest progress report on Price Responsive Demand that PJM sent to FERC¹ and the white paper that PJM prepared for stakeholders and the Board of Managers. We are concerned that these reports do not accurately reflect the degree of stakeholder involvement in developing tariff language and business rules for implementing PRD in PJM. Below, we provide greater context regarding the introduction of PRD and the course of stakeholder deliberations. We also highlight three critical components of the PRD plan that remain unresolved. The undersigned members of the Supplier Caucus respectfully request that the Board consider the additional light shed on the PRD deliberations and recognize the critical, unresolved issues that impede the implementation of a workable PRD product for the PJM energy and reliability markets. After such consideration, we request that the Board direct PJM to address these unresolved matters prior to embarking on litigation before the FERC.

Members of the PJM Supplier Caucus have a wide range of interests in the success of PJM markets. Besides providing supply resources, a number of our members are also EDCs, competitive suppliers of retail load and curtailment service providers. The following comments reflect these diverse interests.

Caucus members are among a large group of PJM market participants who see value in PRD and want to ensure that PRD can successfully be added to the PJM market structure. PJM staff comments about stakeholder inability to finalize and agree on PRD rules are misplaced, and should not be used as a springboard for unilateral action by the Board. While it is true that the PRD concept was introduced in the fall of 2009, PJM staff made no concerted effort to educate stakeholders on the design details until spring 2010, subsequent to addressing more pressing matters undertaken by the Capacity Markets Evolution Committee. PJM's spring 2010 presentations regarding PJM's initial PRD concept revealed to stakeholders a number of design

¹ See PJM Interconnection L.L.C., Compliance Filing, Docket No. ER09-1063 (February 14, 2011)

deficiencies and implementation issues. PJM was at first reluctant to modify its plan, but finally acquiesced to stakeholder requests to address valid concerns. PJM Members worked in good faith to mold PJM's original PRD concepts into a plan that could be implemented by the many involved classes of market participants. That work acknowledged the broad array of market participants, including EDCs, competitive retail suppliers, CSPs, bidders into EDC default supply auctions, and end use customers, who would be affected by the ultimate design.

Notably, in the Fall of 2010, the PRD proposal evolved to remove the requirement that PRD settle nodally and also incorporated a mandate that EDCs accept PRD related to programs approved by the Relevant Electric Retail Regulatory Authority (RERRA). Good progress was being made during Member deliberations in late 2010. Unfortunately critical design features could not be developed before PJM's December 1, 2010 deadline; which was the date by which PJM would have to file tariff revisions with the FERC to permit sufficient time for a FERC Order that would allow PRD to be an option in the May 2011 RPM auction (for the 2014-15 Delivery Year). PJM pulled the plug on the stakeholder process, leaving PJM and stakeholders without consensus on a PRD implementation plan.

The following paragraphs outline a few of the remaining major stakeholder issues with the PRD implementation plan presented by PJM. We believe that these and other valid concerns need to be addressed in any PRD plan that the Board might direct PJM Management to file with FERC.

Nodal settlement – A key concept of PRD is that participating customers must have a retail rate structure that exposes them to a price related to their real time LMP in order to signal when to decrease their price sensitive demands. PJM required nodal settlement for all participating PRD customers in its original plan; but later modified the requirement to be an option.

However, any movement toward nodally-settled loads will have impacts across the PJM market that must be recognized. First, most load in PJM has been and continues to be priced at the load weighted average LMP of each transmission zone. Any carve-out of load to be settled nodally within a zone will change the residual zonal LMP paid by all other loads within a zone. As a result, all of the remaining retail customers in a zone will experience a modified price. Default retail supplies for a number of zones in PJM are arranged through auctions for terms up to three years in advance. Potential bidders into such auctions need information about the amount of load that will shift to nodal settlement, and the likely impact on zonal residual LMPs as they prepare their offers for multi-year supply auctions. Absent such information, suppliers will price the added risk into their offers. Second, customers contemplating a switch to nodal settlement need to be aware of the PJM tariff rule prohibiting nodally-settled customers from ever returning to zonal settlement. The rule was introduced at the outset of retail choice to avoid gaming between paying the lesser of nodal or zonal prices. The PJM plan for PRD does not address either this existing rule or how it would be enforced in a PRD environment.

EDC administrative obligations – The PJM PRD plan neither clearly identifies nor accounts for the new administrative obligations that will be put on all of the Energy Distributors in PJM. Following are two examples. First, a current obligation of each EDC in a customer choice zone is to divide the zonal RPM obligation among each of the retail customers connected to its lines. This process (determining the peak load contribution (PLC) for each customer) is key to ensuring that each customer is responsible for its share of the zonal RPM obligation, no matter whether it chooses to purchase its electric energy needs through utility default service or from a competitive supplier. PRD will impact the PLC calculation for all participating customers. EDCs will have to store and process extra information for expected load reductions based on nodal LMPs, add-backs, PLC adjustments, etc. The PJM PRD plan does not address these new responsibilities. Second, nodal settlement is only possible when an EDC can associate each of its retail electric customers with a specific load pricing point on its transmission system. Designing and implementing customer systems to make these associations, keep them up to date as distribution topology changes, and electronically transfer this new data to both PJM and to competitive suppliers will be a large undertaking. Besides the sheer amount of work involved, these new obligations amount to a form of “unfunded mandate” – new EDC processes required by PJM without any cost recovery mechanism.

Interaction between DSR and RPM – Early on in the PRD discussions, PJM stated a principle that it is more appropriate for loads to participate in the PJM market as price sensitive demands than as supply resource equivalents (offering DSR into RPM auctions). Stakeholders generally agreed with this principle and pressed PJM to develop a transition plan to implement PRD while simultaneously sunsetting most DSR activity on the supply side of RPM. PJM offered a PRD phase-in plan, but never addressed the complementary DSR phase-out plan. Moving the demand side of the supply-demand balance from being a poor analog for physical supply to its proper place as elastic, price sensitive demand is a must-have component of any PRD plan. PJM’s recent FERC filing to add two more flavors of DSR into the supply side of the RPM process has moved the market even further away from the price-competitive supply / price elastic demand model to which PJM aspires. This issue cannot be ignored in any realistic PRD plan.

How PRD affects LMP – A key concept of PRD is that LMPs must be able to rise to levels sufficient to signal PRD loads to decrease when called for by system conditions. PJM staff has not yet been able to show stakeholders how PRD can set LMP when PRD trigger point LMPs are higher than the highest priced offer in a daily supply stack.

Although PJM provided cursory details regarding the interaction of PRD and energy price development in the PRD whitepaper and in abbreviated business rules, PJM failed to provide sufficient detail in the form of proposed tariff or manual revisions. Stakeholders need to be able to see a full package of PRD tariff and manual revisions, as well as a coherent implementation plan in order to assess whether implementation concerns have been addressed.

The signatories to this letter hope that the above information will give the Board a flavor of the issues that remain and need to be addressed before PJM can make a successful PRD filing at FERC. We believe it will be much more effective for PJM market participants to resolve their valid business issues through the stakeholder process rather than through a needlessly adversarial process at FERC. There is time for PJM to coordinate targeted stakeholder deliberations to obtain resolution of remaining deficiencies. Targeted deliberations can be had in time for a FERC filing that would allow PRD to participate in the May 2012 RPM auction for 2015/16 delivery year. We urge the Board to direct PJM staff to work with involved stakeholders to develop a workable PRD plan that can be successfully implemented in the PJM marketplace.

Regards,

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/s/ Frank Francis
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/s/ Steven Schleimer
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