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March 30, 2009

Howard Schneider, Esq.  
Chairman, Board of Managers  
PJM Interconnection, L.L.C.  
955 Jefferson Avenue  
Norristown, PA 19403

**VIA EMAIL AND  
FEDERAL EXPRESS**

**RE: PJM Industrial Customer Coalition's *Ex Parte* Communication on  
Economic Load Response Program Compensation**

Dear Mr. Schneider:

At the March 25, 2009, PJM Members Committee, PJM reported that the Board of Managers will consider Economic Load Response Program ("ELRP") compensation at its upcoming meeting. PJM Industrial Customer Coalition ("PJMICC") appreciates the Board's timely consideration of this important issue and encourages the Board to take action consistent with PJMICC's proposal as well as the principles set forth in several public service commissions' letter to PJM.<sup>1</sup>

PJMICC's proposal is based on the PJM Strawman (as modified to address PJMICC concerns on block and index contracts) with two important modifications: (1) eliminating the automatic customer-specific sunset of full LMP compensation; and (2) providing compensation parity to participating customers regardless of retail contract status. We believe that this approach will advance greater demand response participation while also affording greater transparency and accountability.

***Full LMP Compensation Above a 15% Threshold***

As a threshold matter, PJMICC agrees with Mr. Ott's assessment that the current ELRP is not "sustainable." The automatic sunset of full LMP compensation for ELRP settlements above \$75 in Fall 2007 has led to a marked reversal of the upward trend in ELRP participation. PJM Board action consistent with the PJM Strawman to reinstate full LMP compensation for ELRP settlements above the highest 15% of the hours on a zonal

<sup>1</sup> A copy of the letter, sponsored by the Delaware Public Service Commission, District of Columbia Public Service Commission, Maryland Public Service Commission, New Jersey Board of Public Utilities, and Pennsylvania Public Utility Commissions (collectively, "Commissions"), is attached for your reference.

basis, based on the previous calendar year, is necessary for the ELRP to be "just and reasonable" under the Federal Power Act.<sup>2</sup>

As noted above, PJMICC supports, as a good faith effort to resolve this issue with all stakeholders through a compromise approach, the threshold for full LMP payment being set at no lower than the highest 15% of the hours.<sup>3</sup> The Commissions also support this threshold as being a reasonable compromise when compared with higher thresholds included in utility proposals that would have resulted in "unduly limiting opportunities for demand response." By not limiting the opportunity for incentive compensation to only scarcity and emergency periods, the 15% threshold is a reasonable benchmark to advance the goal of lowering the total cost of energy to customers over a significantly larger period of time, consistent with the objective of markets being used as a vehicle to deliver customer benefits. As suggested herein, PJM should perform regular analyses to assure that the threshold is appropriate to assure that the benefits to all customers outweigh the costs. In this respect, the ELRP assists in overcoming the structural market power issues that exist in all wholesale electric power markets, including transmission constraints, relatively small number of large suppliers, inelastic demand, and high barriers to entry and ongoing participation.

### ***ELRP Compensation Must Not Sunset Automatically***

Under PJM's Strawman, ELRP participants are eligible for full LMP compensation for only three years. For the reasons set forth in the Commissions' letter, PJMICC opposes an automatic or customer-specific sunset for demand response initiatives. The experience of the flash-cut termination of an incentive in 2007 illustrates the dangers of hard-wiring a "date certain" for which incentives should expire. Sound public policy supports a

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<sup>2</sup> PJMICC also generally supports the PJM Strawman's compensation below the threshold: LMP minus the generation rate.

<sup>3</sup> During the lengthy stakeholder debate on this issue, some have referred to full LMP compensation as an inappropriate "subsidy." This perspective ignores, however, the fundamental points raised in the Dissent to the FERC's Order on PJMICC's Complaint, sponsored by now Chairman Wellinghoff and Commissioner Kelley. Specifically, the Dissent found it inappropriate to characterize the payment of full LMP to a demand response provider as a "subsidy": "[w]hen the benefits to all customers outweigh the costs, there is no subsidy to be borne by other customers." *PJM Industrial Customer Coalition v. PJM Interconnection, L.L.C.*, Dissent, 121 FERC ¶ 61,315, at 1 (Dec. 31, 2007)(Commissioners Wellinghoff and Kelly, dissenting). The Dissent also recognized that "offsetting LMP by the demand response provider's 'avoided' retail rate ignores the fact that the load-serving entity (LSE) is avoiding generation and transmission costs that it would have incurred to serve the customer providing demand response." *Id.* at 2. Because of this cost avoidance, the Dissent concludes that "there is no 'subsidy' to recover from other customers." *Id.* Although supporting the 15% threshold in an effort to compromise, PJMICC's preferred approach is to base the incentive threshold on analysis that demonstrates when the benefits to all customers outweigh the costs.

continuation of the incentive until demand response matures. As with other market incentives, however, the ELRP incentive should be carefully assessed and reviewed by PJM, the Market Monitor, and stakeholders periodically to ensure that it achieves its objectives and, if not, it is adjusted accordingly.

To achieve this accountability, PJMICC recommends the PJM Board replace the PJM Strawman's three-year limitation on customer eligibility with a more dynamic process. ELRP compensation should be permitted to continue without a hard-stop in concert with rigorous measurement and analysis of the impact of the incentive on ELRP participation. Examples of possible metrics to gauge the effectiveness of the incentive include (but are not limited to): (1) analysis of the supply curve on the cost-benefit of the incentive levels; (2) tracking the frequency and quantity of demand response across the LMP spectrum to determine the impact of price on customer participation; and, (3) tracking the amount of demand response during PJM's monthly peak hour.

With the information gleaned from this analysis based on actual ELRP participation, it may be appropriate, over the course of time, to adjust the pricing level at which an incentive is available in a more dynamic fashion. For example, many initiatives are underway, both at the federal and state level, to promote demand response. As a result, demand response penetration could improve, militating toward a reduction in the incentive over the course of time. Conversely, it may be appropriate to increase the availability of the incentive if demand response objectives are not being achieved.

### ***ELRP Compensation Must Not Discriminate Based on Retail Customer Contracts***

The PJM Strawman tailors its compensation for ELRP participation based on retail contract status. Although we commend PJM for recognizing the need for "incentive treatment" for such customers,<sup>4</sup> the different approach to compensating these customers is arbitrary and may have the unintended effect of jeopardizing cost-effective demand response, particularly for customers on Day-Ahead LMP contracts.

PJM's Strawman provides a fixed \$75 incentive for LMP customers participating in the ELRP above the threshold as a proxy for an average generation rate that may be found in a fixed price retail contract. There is no need to use a proxy, however, for customers on Day-Ahead LMP contracts. The Day-Ahead LMP customer's generation "rate" is more accurately fixed at its committed price in the Day-Ahead market. When such customers are committed in the Day-Ahead market, their participation in the Real-Time market has the same effect on the market as a customer on a fixed price. No basis exists to treat such customers differently than fixed-price customers. Accordingly, PJMICC's Motion provides

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<sup>4</sup> While some may assume that customers on LMP-based contracts are already "price responsive," such assumptions ignore that many of these customers have hedging mechanisms in place that mask the price of power at a particular point in time.

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that customers on Day-Ahead LMP-based contracts would be treated akin to fixed-price customers when participating in the Real-Time market.

The impact of a megawatt reduction to the market is the same regardless of the retail contract status of the customer. Demand reductions by customers on Day-Ahead LMP contracts have the same economic impact as reductions by fixed-price customers. On the supply side of PJM markets, no discrimination in compensation occurs. Different types of generators with different cost structures are paid identically under the last-bid-in clearing mechanism. Compensation for demand response participation should be no different.

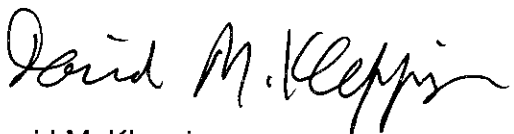
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As with the supply side of the market, customers need the appropriate market structures and rules to give them the incentive and opportunity to respond to prices. To increase the amount of demand response in the PJM market and improve the market's demand elasticity, the ELRP must afford the appropriate incentives and meaningful opportunities to respond. PJMICC's proposal, which is based on the PJM Strawman, re-orientes the PJM ELRP in an effort to reverse the downward trend of ELRP participation in order to provide customer benefits while encouraging greater program accountability.

Thank you for your consideration of PJMICC's concerns as you deliberate on this important issue.

Very truly yours,

McNEES WALLACE & NURICK LLC

By 

David M. Kleppinger  
Robert A. Weishaar, Jr.  
Susan E. Bruce

Enclosure

c: Mr. David A. Anders, P.E., PJM Interconnection, L.L.C. (via email)



STATE OF NEW JERSEY  
**BOARD OF PUBLIC UTILITIES**

**PUC** Pennsylvania Public Utility Commission



March 12, 2009

Andrew L. Ott  
Senior Vice President, Markets  
PJM Interconnection, L.L.C.  
955 Jefferson Avenue  
Norristown, PA 19403

Re: Economic Load Response (Demand Response Compensation)

Dear Mr. Ott:

This letter is submitted on behalf of the Maryland Public Service Commission, the District of Columbia Public Service Commission, the New Jersey Board of Public Utilities, the Pennsylvania Public Utility Commission, and the Delaware Public Service Commission (together, the "Commissions") in support of appropriate demand response compensation principles for PJM's Economic Load Response Program ("ELRP").

The Commissions seek PJM's support for a demand response incentive that is available often enough, is stable enough, and is large enough to support robust, ongoing investments in end-user demand response capability. The Commissions also recognize the importance of having an incentive that can be approved and implemented as quickly as possible.

PJM and the Commissions have both recognized the importance and the value of demand response, as a cost-effective capacity resource and as a cost-effective means of mitigating peak prices in the energy market. Even before the Federal Energy Regulatory Commission ("FERC") stated in Order 719 that "reforms must ensure that demand response resources are treated on a basis comparable to other resources,"<sup>1</sup> PJM had been a strong supporter of demand response, working extensively with stakeholders to incorporate demand response resources into its energy,

<sup>1</sup> Wholesale Competition in Regions with Organized Electric Markets, Order No. 719, 125 FERC ¶61,071, at P 14 (2008).

ancillary services and capacity markets.<sup>2</sup> The Commissions have undertaken retail programs complementing the PJM efforts in the wholesale markets; for example since the beginning of 2008, the Maryland, District of Columbia, New Jersey, Pennsylvania, and Delaware Commissions directed electric distribution companies in their respective states to develop and / or implement demand response programs and to procure demand response that the market has not delivered. Additionally, the Pennsylvania Public Utility Commission will be reviewing and monitoring the implementation of aggressive demand reduction programs required for compliance with Pennsylvania Act 129 of 2008

The Commissions' strong interest in demand response initiatives has not been limited to actions undertaken within their own jurisdictions. The Commissions have also closely followed demand response efforts in the wholesale markets designed and administered by PJM, and have shared PJM's concern that thus far economic demand response has not yet matured in the PJM markets.<sup>3</sup> In December 2007, the Maryland and Pennsylvania Commissions sought to extend the PJM Open Access Transmission Tariff (OATT) provisions that contained locational marginal pricing (LMP) payments for economic load response participants, and supported the complaint filed by the PJM Industrial Customer Coalition ("PJMICC") in FERC Docket EL08-12-000 which argued that the sunset provisions were unjust and unreasonable. As the Maryland Commission stated in its request to extend the PJM ELRP provisions in 2007, demand response resources should be provided the opportunity to receive just and reasonable compensation for the benefits they bring in mitigating peak demand for electricity.

Despite the Commissions' disappointment in the December 2007 sunset of the ELRP, we appreciate PJM's efforts to reinstate incentive compensation for economic demand response. We also welcomed the Markets and Reliability Committee's ("MRC") February 25 rejection of two incentive compensation proposals by utilities and generators which would have failed to provide incentives stable enough, or available often enough, to support investments in demand response capability.

The Commissions urge PJM to support the following principles when considering proposals (possibly including the PJM Straw Proposal) to encourage and compensate demand response:

**1. Incentive compensation for demand response must not sunset automatically.**

Unlike the Allegheny/FirstEnergy/PHI proposal, under which customer's incentive payments for demand response would have ended after three years and the PSEG/Exelon proposal, under which incentive payments would have ended after two years, the Commissions recommend that there be no automatic or "customer-specific" sunset provisions for demand response programs. Quick and automatic sunset of incentives tend to discourage customers from making the investment needed to support demand response capability. The Commissions believe there should be no automatic or customer-specific sunsets for demand response incentives.

**2. The threshold for demand response incentive payments should be set at 15%.**

The Commissions submit that PJM's proposal regarding the hours during which incentive compensation would be available represents a reasonable compromise. The PJM proposal would make incentive payments available when the local energy price exceeds a certain threshold. To set the threshold, PJM would look back at the previous calendar year; identify the price level that was exceeded in 15% of the hours during that calendar year; and set that price as the threshold for incentive payments in the current calendar year.

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<sup>2</sup> Answer of PJM Interconnection, L.L.C. to Motions for Partial Summary Disposition, Docket No. ER09-412-000, January 5, 2009, p. 2.

<sup>3</sup> Answer of PJM Interconnection, L.L.C. to Complaint of PJM Industrial Customer Coalition, Docket No. EL08-12-000, December 6, 2007, p. 2.

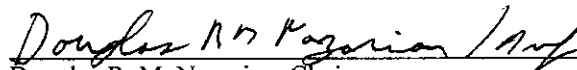
In contrast, the Allegheny/FirstEnergy/PHI proposal would have set the threshold at 5% instead of 15%, and would have created confusion by adjusting the threshold monthly. The PSEG/Exelon proposal would have been even more restrictive, allowing incentive compensation only during emergencies. Those proposals were entirely too restrictive, and would have resulted in unduly limiting opportunities for demand response and discouraging the investments needed to make demand response capability available.

**3. In determining whether and how incentive compensation would differ for customers paying real-time prices, fixed prices, or some other pricing structure, PJM should consider the extent to which reducing compensation to any of these classes of customers reduces the savings in energy and capacity costs that could be achieved if incentive compensation were uniform.**

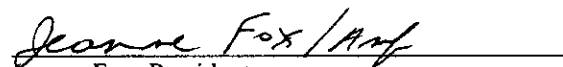
The Commissions recognize that PJM has sought to tailor incentives based on the energy pricing faced by the customer who is implementing the demand response measure. However, the Commissions also recognize the value of demand response in maintaining reliability cost-effectively, and in helping to ease volatility in wholesale electricity prices. Thus, the Commissions believe that PJM could design incentive compensation for demand response with less emphasis on the precision with which the amount of compensation is tailored to the circumstances of a particular customer, and more emphasis on whether the compensation is sufficient to spur as much cost-effective demand response as can be obtained.

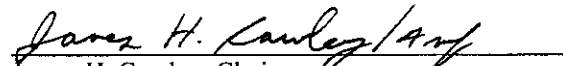
We expect that our staffs will participate in the discussion at the March 18 MRC meeting, and we would also welcome an opportunity to speak with you informally in advance of that meeting. Thank you for your attention to this important issue.

Sincerely,

  
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Douglas R. M. Nazarian, Chairman  
Maryland Public Service Commission

  
\_\_\_\_\_  
Betty Ann Kane, Chair  
District of Columbia Public Service Commission

  
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Jeanne Fox, President  
New Jersey Board of Public Utilities

  
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James H. Cawley, Chairman  
Pennsylvania Public Utility Commission

  
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Arnetta McRae, Chair  
Delaware Public Service Commission

cc: Bill Whitehead, VP, State Govt. Policy, PJM