UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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PJM Interconnection, L.L.C.	)	Docket No. EL09-68-000
	)	

MOTION FOR LEAVE TO ANSWER AND ANSWER OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 213 of the Commission's Rules and Regulations, 18 C.F.R. § 385.213 (2009), Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[1] ("Market Monitor"), submits this motion for leave to answer and answer to protests filed by certain intervenors in the above captioned proceeding. Numerous intervenors have filed comments in these proceedings[2] that would have the Commission require PJM to pay demand response providers LMP plus the payments avoided by the decision not to consume at all times and for customers taking service under both fixed price and LMP contracts (hereafter, "LMP Plus Proposal"). The LMP Plus Proposal is inconsistent with the fundamental economics, and, if accepted by the

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1 PJM Interconnection, L.L.C., a FERC approved Regional Transmission Organization. Capitalized terms used herein and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT") or the PJM Proposal, as defined *infra* footnote 4.

2 Such comments include those filed by Comments and Protest of Demand Response Supporters, including: Comverge, Inc.; EnergyConnect, Inc.; EnerNOC, Inc.; the PJM Industrial Customer Coalition; Viridity Energy, Inc.; Wal-Mart Stores East, L.P.; Protest of the New Jersey Board of Public Utilities and the District of Columbia Public Service Commission ("BPU/DCPSC"); and Comments of the Public Service Commission of Maryland ("PSCMd").

Commission would over compensate participants in PJM's Economic Load Response Program ("Economic Program"), degrade the efficient operation of the energy markets and provide no offsetting social benefit.

As this Commission, numerous commenters, PJM and the Market Monitor have recognized, demand side response programs have great potential to enhance the operation of organized energy markets in advance of the development of full demand-side participation in the markets. This potential will be frustrated, however, if the structure of demand side programs is allowed to distort the markets and such programs become vehicles for the inefficient transfers of wealth from certain classes of load to other classes of load and from generation to load. The Commission should, therefore, act to protect the integrity of demand side response programs in PJM, reject the arguments raised by advocates of the LMP Plus Proposal and accept PJM's revised pricing proposal for its Economic Program except its inclusion of incentive payments to LMP customers.

I. BACKGROUND

On August 26, 2009, PJM Interconnection, L.L.C. proposed revisions to Schedule 1 of the Operating Agreement,[3] which set forth the rules applicable to participation in its

[3] The key provisions affected are OA Schedule 1 §§ 1.5A.0, 3.3A.4 & 3.3A.5.

Economic Load Response Program.[4] PJM explained (at 5) that its ultimate goal is to "transition to price responsive demand," and that the proposed revisions to its Economic Program are intended to facilitate that transition. PJM's specific proposals include (i) compensation for Fixed Priced Customers pricing at (LMP – G) during all but the defined high price hours,[5] (ii) debit of payments under certain conditions and (iii) incentive payments for participation in demand response by both Fixed Price and LMP Customers during the nine percent of highest LMP levels that would sunset when "there is additional price responsive demand capability (1,000 new megawatts) for small and medium-sized end-use customers."[6]

The Market Monitor has made known its views on the importance of developing the demand side of the PJM markets over the long term,[7] the need for appropriate pricing for an efficiently and rationally integrated Economic Program in the short run, and, therefore, supports PJM's long-term goal of developing the demand side of the energy markets and its proposed pricing for Fixed Price Customers under the Economic

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4 PJM submitted this proposal in the form of a "Supplemental Report and Submittal of PJM Interconnection, L.L.C. in Support of Further Commission Action on Rehearing" in Docket No. EL08-12 ("PJM Proposal"). The Commission noticed this filing in the above referenced docket on August 31, 2009, and ultimately set a comment date of September 28, 2009. The Market Monitor submitted a doc-less motion to intervene on September 28, 2009.

5 Locational Marginal Pricing ("LMP") less the generation component of any applicable retail electric service rate ("G").

6 PJM Proposal at 6–7.

7 *See*, *e.g.*, 2008 State of the Market Report for PJM at 9.

Program.[8] The proposed debits for payments under defined conditions constitute efficient and objective means to protect the integrity of the Economic Program. The Market Monitor would prefer omission of the incentive program, and objects, in particular to any incentive payments for customers already fully exposed to hourly LMP pricing.[9] However, the Market Monitor limits its comments to positions of commenters that would, if accepted by the Commission, distort the performance of the Economic Program over the long term and could interfere with the desired transition to fully price responsive demand.

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8 *See* Barriers to Demand Side Response in PJM filed in Docket No. RM07-19-000 (July 1, 2009), which the Market Monitor posts at *http://website/reports/Reports/2009/Barriers_to_Demand_Side_Response_in_PJM_20090701.pdf*; MMU White Paper: PJM Demand Side Response Program (December 4, 2007), which the Market Monitor posts at *http://www.monitoringanalytics.com/reports/Reports/2007/20071204-dsr-whitepaper.pdf*.

9 Given that the appropriate rationale for the payment of incentives is that demand side participation faces barriers to entry, an alternative approach to the payment of incentives would be preferable. Under the alternative approach, incentives would be paid only to new, Fixed Price Customers in the Economic Program and incentive payments would be limited to the first three years of participation in order to overcome the barriers to entry. The duration of the incentive program could continue to be limited as provided in PJM's filing. This approach has the advantage of targeting the incentive to new customers that do not already pay LMP in order to overcome the barriers to entry but would not continue to pay incentives to such customers after three years. If, after three years of experience, customers conclude that the payment of (LMP - G) is not adequate and that they do not plan to become LMP customers, then their choice to not participate is both efficient and fully informed. It is inappropriate to provide any payment under the Economic Program to LMP customers, as they already face the market price.

II. COMMENTS

A. Adoption of the LMP Plus Proposal Would Result in Inefficient Overpayment for Demand Side Resources.

The assertion that customers who agree not to use energy during an hour should receive full LMP is correct.[10] The assertion that such customers require a payment under the PJM DR programs equal to full LMP is not correct.[11] The difference between these two assertions is the source of much of the confusion in the responses to PJM's proposal and much of the disagreement.

There is no disagreement that the correct price signal for all customers is LMP. When a customer who pays LMP decides to consume one less MWh, its benefit is the price of that MWh that it avoided paying, the LMP in this case.

When customers know and pay the market price, the behavior of those customers is consistent with the market value of electricity. Conversely, when customers do not know the market price or do not pay the market price, the behavior of those customers is not consistent with the market value of electricity. The transition to a more functional demand side ultimately requires that the default energy price for all customers be the hourly LMP rather than a fixed price.

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10 Demand Response Supporters at 8–9, 11; BPU/DCPSC at 9

11 Demand Response Supporters at 10–11, 30; PSCMd at 2, 5, 7–8.

Until this transition to LMP pricing for all customers occurs, PJM's Economic Program serves a very important function.[12] A properly designed program permits customers to receive compensation for load reductions equal to LMP even where the wholesale power component of the retail energy price is not LMP. The Economic Program accomplishes this by attempting to replicate the price signal to customers that reduce load that would exist if customers were exposed to the real time wholesale price of energy, and by providing settlement services to facilitate the participation of third party Curtailment Service Providers ("CSPs") in the market.

Most retail customers pay fixed rates for wholesale power that do not vary by hour despite the fact that the wholesale price of power, LMP, does vary by hour. The portion of the retail rate designed to recover the cost of wholesale power is termed "G," for generation. Fixed Price Customers pay G when LMP is significantly higher than G. Customers also pay G when LMP is lower than G. As a general matter, such customers do not know LMP in real time and they would not benefit even if they reacted to LMP by reducing or increasing their demand for electricity.

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12 The Market Monitor is hopeful that this will occur expeditiously. Other commenters' views are mixed. *Cf* Demand Response Supporters at 19 ("Even in the unlikely event that PJM's vision of widespread dynamic pricing at the retail level, supported by ubiquitous deployment of smart meters were to occur, adequate compensation for economic demand response would still be necessary"); BPU/DCPSC at 5 ("[R]etail jurisdictions within the PJM footprint are rapidly moving towards making price responsive rates available to retail customers. PJM is concerned about a problem that will solve itself without PJM's involvement").

Demand response programs are intended to change this dynamic. Fixed Price Customers save G when they reduce consumption, but G may be below the price at which they will reduce consumption. Since Fixed Price Customers pay G for wholesale power, the portion of the wholesale power price they do not pay is equal to (LMP – G). By paying such customers (LMP – G), the Economic Program restores the full market price signal such that customers retain the full economic savings from the decision not to buy at a particular LMP.[13] The result is that customers' decisions about consuming power are based on the actual market price of wholesale power.

PJM's proposed Economic Program is designed to provide the appropriate price signal to such retail customers by paying (LMP – G) to such customers when they curtail. Any payment to Fixed Price Customers in addition to (LMP – G) constitutes compensation in excess of LMP.

Demand side resources are not generation. In a well functioning market, demand side resources avoid paying the market price of energy when they choose not to consume. This allows customers to make efficient decisions about using power. It also

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13 "G" serves solely as an input to this simple calculation. Without "G," there is no way to determine the correct net payment to customers to ensure that demand side customers save the full LMP when they avoid consuming. This arithmetic involves no attempt to evaluate the level or the appropriateness of G. Consequently, the argument raised by Demand Response Supporters (at 12–14) and BPU/DCPSC (at 5) that PJM's proposal would encroach on the jurisdiction of the entities charged to make such evaluations and to perform such scrutiny is a red herring.

follows that a customer receiving more than the market price as an incentive to curtail will make inefficient decisions about using power, and that this inefficiency imposes a cost rather than providing a benefit to society.

The fact that the Economic Program makes payments to participants has also created confusion about the role of payments. The payments to demand side participants are not analogous to payments to generators. Generators provide power and are paid for that power. When customers choose not to use power the benefit is that the customer does not have to pay for that power. No additional payment is required or appropriate. The only reason that payments are appropriately made under the Economic Program is to ensure that Fixed Price Customers actually save the full LMP when they choose not to use power. When customers pay the LMP, no payments are required or appropriate.

Supply and demand resources should both be treated in a manner consistent with fairness and economic efficiency that reflects the actual nature of these resources' participation in the market.

Retail customers who already pay the hourly LMP for energy are already receiving the correct price signal. The hourly LMP equals G for such customers. As a result, the appropriate payment to such customers is (LMP – G), or zero, as it would be under the PJM Proposal for most hours. A zero payment under the Economic Program is exactly the correct payment because these customers already save the full LMP by not consuming. To pay such customers LMP in addition, under the Economic Program, would be to provide a dramatically inefficient price signal to such customers to reduce load in an inefficient manner by paying them two times the value of energy when they reduce consumption.

PJM proposes to pay an additional amount to both retail customers who pay fixed rates and retail customers who pay LMP, for hours when prices are high compared to the rest of the year, which PJM asserts is the highest price 9 percent of all hours in a year. This additional amount is G for customers on fixed rates and is an estimate of average G (set at $75 per MWh based on the payments to customers on fixed rates) for customers who pay LMP. This additional amount is what is termed the "subsidy" or the "incentive." Neither term is a pejorative. Both terms mean that the payment is over and above the competitive market price but that the additional payment is justified by a policy objective that cannot be reached without the additional payment for reasons of limited information, barriers to entry or other imperfections in the market. The merits of a subsidy or an incentive must be informed by its relationship to and the merits of the relevant policy objective.

In this case, the subsidy or incentive is appropriate because demand side participation faces barriers to entry. But the incentive should be more narrowly tailored to the policy objective and should not be open ended.

While this argument for the incentive makes sense for Fixed Price Customers, it does not make sense for LMP customers. LMP customers are typically large, sophisticated customers who are well aware of the actual LMP in real time and who already make rational decisions about whether it is economic for them to reduce consumption in order to not pay the price of energy, LMP. These customers do not need an extra incentive. Such customers historically have received the bulk of the incentive payments, which would be more efficiently targeted at the smaller, less sophisticated Fixed Price Customers.

B. Adoption of the LMP Plus Proposal Would Not Provide Social Benefits.

The proponents of the LMP Plus Proposal appear to believe that an incentive program that results in lower market prices provides a social benefit measured by the reduction in prices.[14] This is not based on the fundamental economics. The market price that results when customers can see and react to and benefit from prices and when generation owners are providing power when the market price equals or exceeds their short run marginal cost is the efficient price. This price reflects customers' willingness to pay for power and reflects the costs of generating power.

The basic proposed Economic Program payment of (LMP - G) helps ensure this result by increasing the number of retail customers who see the actual LMP rather than their fixed retail rate, which is too high at times and too low at times. The wide

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[14] *See* Demand Supporters at 17, 37.

dissemination of smart meters and exposure of retail customers directly to LMP would further help ensure this result.

It is reasonable to expect that the market price which results when customers receive an accurate price signal (LMP) will be less than the price which reflects customers' inability to see and react to and benefit from prices. But it does not follow that providing a price signal in excess of the market value of power provides a benefit by further reducing the price of power.

Some of those who support the LMP Plus approach assert that those who reduce load are providing a social benefit, over and above the direct benefit they receive from reducing load, because the result of reducing load is also to reduce the market price. The conclusion drawn is that such customers should receive an incentive to reduce load even more. The proponents of this view prove too much, as there is no logical limit to the amount of the subsidy or incentive that such logic could support. If paying twice LMP is good, why is paying three times LMP not even better?

The fundamental value of electric power to customers derives from all of the activities that require the use of electricity. If markets are to work, the decision to consume must be based on the ability to compare the cost of power to the value of the desired activity. No benefit to society will result from creating price signals not based on an efficient market outcome.

III. MOTION FOR LEAVE TO ANSWER AND ANSWER

This answer is necessary to provide for a more complete record that will facilitate the Commission's decision making process. The Commission has found good cause exists to accept an answer when the answer helps the Commission understand the issues and provides useful and relevant information that will assist the Commission in its decision-making process.[15] For these reasons, the Market Monitor requests that the Commission waive the rule against answers to protests[16] and consider the information herein as it resolves the issues raised here.

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15 *See, e.g., Public Service Company of New Mexico*, 128 FERC ¶61,017 at P 11 (2009) ("We will accept [various answers to protests] because they have provided information that assisted us in our decision-making process."); *Midwest Independent Transmission System Operato*r, 128 FERC ¶61,007 at P 15 (2009).

16 18 CFR § 385.213(a)(2).

IV. CONCLUSION

The Market Monitor respectfully requests that the Commission accept and afford due consideration to this answer.

Respectfully submitted,

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Dated: October 16, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 16th day of October, 2009.

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