

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Demand Response Compensation :
in Organized Wholesale : Docket No. RM10-17-000
Energy Markets :**

**Opening Remarks of
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Technical Conference Regarding

**Demand Response Compensation -
Panel 2 – Cost Allocation**

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CHAIRMAN WELLINGHOFF AND MEMBERS AND STAFF OF THE COMMISSION

My name is Sonny Popowsky. I have served as the Consumer Advocate of Pennsylvania since 1990 and I have worked at the Office of Consumer Advocate since 1979. Thank you for the opportunity to speak at this Technical Conference on behalf of Pennsylvania electricity consumers regarding the critical issue of demand response compensation in wholesale markets. My Office joined with several other state consumer advocate offices in Comments filed on May 13, 2010, in support of the Commission's original proposal at this docket to require that demand response that is dispatched in regional wholesale energy markets be compensated at full market clearing prices.

Before addressing my general support for the Commission's proposal and the allocation of costs resulting from this proposal, which is the specific topic of this panel, I would like to provide the Commission with some background as to why this issue is of such great importance to electric consumers in Pennsylvania. As many of the Members and Staff of this Commission may recall, Pennsylvania was one of the first states to restructure its electric industry. In legislation passed under the leadership of Governor Tom Ridge in 1996, Pennsylvania opened the generation portion of the industry to competition. At the same time, however, Pennsylvania implemented a lengthy "transition" period from regulation to competition during which utilities were allowed to recover "stranded costs" to protect them against the expected losses in value of their generation plants, and consumers were protected by retail rate caps so that they would not have to pay **both** stranded costs and higher than expected generation market prices. The last of those stranded costs will be paid and the last of the rate caps will conclude at the end of 2010. As a result, after January 1, 2011, essentially all of the generation service that is provided to Pennsylvania retail consumers will no longer be provided at embedded cost-based regulated

rates, but instead will be provided – either by utility default service providers or by unregulated retail marketers – at prices that are largely established in the PJM wholesale market.¹

One of the key features of the PJM energy market is the use of the single market clearing price methodology under which all generating units that are dispatched in a given hour are paid the price bid by the highest priced generating unit that is dispatched in that hour. While only a fraction of the generation sold to Pennsylvania consumers is purchased each day in the PJM spot energy markets, there is no question that the price of all power sold in PJM, whether through spot purchases, block power purchases, full requirements contracts, or even long-term contracts is heavily influenced by the actual and anticipated energy prices that are produced in the PJM energy markets. While prices in the PJM energy markets are currently quite low due to low fossil fuel prices and the severe economic slowdown, we have seen the catastrophic results in states such as Maryland when rate caps came off at a time when PJM prices were extremely high.

In my view the current FERC Notice of Proposed Rulemaking (NOPR) represents an important and potentially highly beneficial effort to prevent excessive energy prices in wholesale markets such as PJM. Since those wholesale prices are passed on to retail customers in Pennsylvania, I am extremely supportive of this effort. To the extent that demand response programs can in fact displace higher cost generating units in the PJM dispatch, then the impact on the cost to customers who are purchasing power through the PJM energy markets can be profound. That is because of what I refer to as the “multiplier” effect of the single market clearing price mechanism. Each time that a higher priced generating unit is dispatched, that higher price is multiplied across every one of the thousands of megawatts of generating units that

¹ All of Pennsylvania electric utilities are now or are about to become part of PJM except the tiny Pike County Light & Power Company in Northeast Pennsylvania. Pike is an affiliate of a New York utility and is served through the New York ISO.

are operating in that hour. When a demand response program is implemented instead of bringing on a higher cost generating unit, the exact opposite occurs – that is, the *avoided* increment to the market clearing price is multiplied across every generating unit that is operating in that hour and the savings flow to customers. As long as the incremental cost of paying for the demand response compensation is less than the savings produced by any reduction in generation costs resulting from a lower market clearing price, then all customers who are purchasing power in that market at that time will benefit.

The issue of how to determine when the benefits of the demand response programs will exceed their additional costs was the subject of the first panel at this Technical Conference. But once that issue is decided, I believe that the question of how those costs should be allocated follows straightforwardly from the prior discussion. That is, all customers who are purchasing generation in the affected market at the time the demand response programs are dispatched should share in the costs.

While the Comments initially filed by my Office at this docket did not reach the cost allocation issue, I believe that this question was clearly and correctly addressed in the Comments filed by the New England Conference of Public Utility Commissioners (NECPUC). The NECPUC Comments support the payment of full LMP to demand response resources, but only in those hours when the use of those resources provides net benefits to all market customers. NECPUC, as well as a number of other parties such as the Consumer Demand Response Initiative (CDRI), have discussed the question of how to ensure that **all** customers receive net benefits as a result of including demand response resources in the system dispatch even when the additional costs of paying full LMP to those demand response resources is included in the system

costs. But once that determination is made, I believe that NECPUC was correct when it made the following recommendation regarding Cost Allocation at page 22 of its Comments:

NECPUC recommends allocating the costs of procuring demand response resources to all customers purchasing from the relevant energy market in the hour when the demand response resource is committed or dispatched. The rationale for this approach is that it allocates the costs of demand response resource procurement on the basis of cost causation, i.e. demand response resource costs are allocated directly to those energy market consumers who benefit from the demand response service provided.

I agree with the NECPUC Comments that this is essentially a matter of establishing cost causation and assigning the costs to those who benefit. Again, as long as the incremental cost of spreading the demand response compensation across all affected load is less than the savings that result when the demand response resources displace higher cost generation, then all affected load will benefit. As such, it is appropriate that all customers who receive that benefit, whether that be on a zonal, or multi-zonal, or RTO-wide basis, should share in the costs.

Thank you again for inviting me to speak at this Technical Conference. I look forward to participating in the rest of this panel discussion and answering any questions that you may have.

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