

**Comments of the California Manufacturers & Technology Association  
and Energy Users Forum on the CAISO's Proposal for Post-Release 1  
MRTU Functionality For Demand Response**

Developing cost-effective demand response options is a difficult task. Indeed, the CPUC has been struggling with the issue of creating cost-effective tariff options that will produce demand response for a number of years. One reason cost-effective demand response has been difficult to achieve is that demand response has not been able to obtain Ancillary Service<sup>1</sup> and capacity payments. Without that compensation there has not been sufficient incentive available to pay for the infrastructure and provide compensation for the lost opportunity. CMTA and EUF believe that a properly constructed DDR program has the potential to provide the additional income necessary to close the gap and enable Load Serving Entities (LSEs) and third party providers to develop the cost-effective, attractive demand response products that are vital to shave the system peak, support reliable operation of the grid and respond to variations in wind production. To obtain these benefits we need a thoughtfully developed DDR structure that provides appropriate incentives, does not create unintended consequences or adverse results and is accessible to all interested customers. The development requires the active consultation with and contributions of ALL affected stakeholders including customer representatives and their service providers. Unfortunately the DDR program proposed by the CAISO fails on all these counts as it is fundamentally flawed in three key areas: policy, procedure and design.

The current DDR proposal settles all participant transactions (usage and response) at a Custom LAP (CLAP) rather than the Default LAP based on a misunderstanding or lack of knowledge of fundamental MRTU policy adopted by the CAISO Board. (See TURN's comments on this issue which are being incorporated by reference). Representatives of the commenting parties have followed board action from the institution of the board and one representative was a board advisor after the Stakeholder Board was replaced. There was an explicit, deliberate adoption by the ISO Board of a policy that all Customer usage, with very few defined exceptions, would be settled at the default IOU LAP price. (See also TURN comments) This decision was made after much discussion, thought and interaction with the MSC. The policy was set in order to prevent inappropriate cost-shifting and non-beneficial strategic behavior (also called gaming) that would result if settlement at the nodal prices or sub-aggregations of the LAPs were allowed. One cause of the negative consequences was the arbitrage opportunity created due to differences between the wholesale (ISO) and retail (IOU/CPUC) tariffs.

The procedure that was used to develop this proposal has been flawed. There have been two major procedural flaws. First, the proposal was created without participation of the representatives of customers or direct access providers. Representatives asked to be included in the sub-team, but were denied. We also know that others had details of the plan before it was shared broadly with entities like

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<sup>1</sup> There has been a specific exemption that allowed the Department of Water Resources- State Water Project (SWP) to receive reserve payments for pumped load. However, other loads have not meet the requirements for participation.

ourselves who had expressed an interest in demand response, as we recently discovered a September PG&E filing at the CPUC expressing concern about Custom LAP implementation. Furthermore, as we learned the names of the products and reviewed the CAISO website, we found CAISO presentations posted that introduced the terms to other stakeholder groups before the CAISO posted its DDR proposal.

Secondly, the procedural timeline requested by staff does not allow enough time for all parties to discuss the issues and create a solution; the proposal was issued on 10/30, partially explained in a meeting on 11/5, the one and only set of comments required by 11/12 and the staff issuing a final proposal on 11/19. In the last week, we have had limited off-line discussions that have raised more questions than they have answered. The response to those issues deemed valid by staff was that they would be resolved during the User Guide creation process. If the design is fundamentally flawed, tinkering with it in the User Guide creation process cannot fix the problem.

There are very significant design issues. Settling DDR customers at CLAPs will create two groups: those at CLAPs with prices lower than the default LAP price and those at CLAPs with a higher price. The former will have an incentive to participate in DDR even if they cannot respond because signing up will reduce their overall cost. If the design flaw stays open, entities will develop just to aggregate these customers and share in the savings. If the CAISO does a diligent job in reviewing CLAP applications, this problem would be reduced, however will the CAISO be able to be a perfect arbiter? We interpret from our most recent communication with the CAISO staff that they do not plan on evaluating the CLAP applications. Either way there is an issue. For the customers in the latter group, they will have a large hurdle to overcome as all of their consumption will be priced at a higher price just because they choose to participate in DDR.

The CAISO further contends that the higher CLAP prices won't be an issue, as the differential will be offset by CRR revenue. As we have stated now and in the past, the CRRs present adequacy, accuracy, and allocation issues. This particular proposal also creates aversion issues: customer risk aversion. For example, the CRRs will be inadequate because they do not reimburse for increased losses; the CRRs will be inaccurate because they are issued in four time blocks and customers do not consume equal amounts of hourly energy within each time block, and the CRRs will be issued by sub-LAP which most likely will be different than the CLAP; furthermore, there will be CRR allocation issues because they may not be issued to the entity that applied for the CLAP (non-LSE third parties) and they won't be available for allocation until the third tier of CRRs is issued. In addition, if one expects CRRs to keep customers whole in the long run, one must face the issue that end-use customers are risk averse and put a large premium on uncertainty and risk in areas other than their core businesses. Furthermore, the customer may not be in the program for the entire period the CAISO considers the long run. This is just a sample of the issues related to CRRs. The commenting parties and others have provided many additional examples over time.

During the last conversation between a representative of the commenting parties and the CAISO staff the CAISO staff said that there would not be settlement issues for bundled customers in high priced

CLAPs. Staff alleged that the utilities would not charge the participating customers the CLAP price, but rather the default LAP price and spread the difference among all its customers. I am not sure the utilities agree that bundled customer implementation is not an issue, as explained in TURN's comments (incorporated by reference), there has been testimony filed at the CPUC explaining the significant infrastructure costs the utilities would incur if CLAPs were implemented. However, supposing the CAISO is correct that bundled customers won't be adversely impacted at high priced CLAPs, it is not acceptable or beneficial to the state as a whole to implement a system that by its nature precludes participation by DA customers at high cost CLAPs because they have to pay a premium on all of their usage just to participate in DDR. DA customers have a number of attributes that make them exceptional candidates for DDR type demand response programs. First DA customers tend to be larger than the average customer. The larger the volume, the shorter the payback period on the necessary infrastructure. Large customers often have staff that could evaluate demand response proposals brought to them by vendors. Large customers tend to care about small volumetric savings. DA customers also tend to be the more sophisticated customers. These are the customers that would be more likely to understand the risks and rewards of demand response. Sophisticated customers also understand their loads better and often have invested in additional infrastructure already.

In the last conversation between a representative of the commenting parties and CAISO staff, it was intimated that the high cost LAP issue would not be an issue for ESPs because they could spread the extra cost to their other customers. This is not true. Even if most contracts didn't prevent the allocation of costs attributable to another customer, that ESPs' cost of service would increase and the ESP would lose its customers because DA customers will not stay with an ESP with expensive fees. The CAISO staff said they couldn't discount their theory because they didn't know how ESP contracts were structured. EUF can state on behalf of the commenting parties, that the consultants that work with EUF do. They have seen dozens of DA contracts and they all call for pass-through of the customer's CAISO costs without mark-up.

We appreciate the effort that staff has put into their proposal, but more effort is needed as at present it is fundamentally flawed in the three areas cited above. Any one of those areas is a fatal flaw. We request that the CAISO reconvene the stakeholder process and design a DDR structure that will maximize the benefit to California by maximizing the cost-effective response.