CDWR-SWP Comments to CAISO regarding Demand Response and the March 12, 2009 Joint Market Surveillance Committee and Stakeholder Meeting

March 20, 2009

California Independent System Operator (CAISO) hosted a joint Market Surveillance Committee of the California ISO (MSC) and Stakeholder meeting on March 12, 2009 to discuss, in part, the CAISO's March 5, 2009 Straw Proposal for the Design of Proxy Demand Resource (PDR) and Impacts of Direct Participation. The California Department of Water Resources State Water Project (CDWR-SWP) appreciates the opportunity to comment and submits the following:

Reiterating previous comments to CAISO made on 12/26/2008 and 1/22/2009, CDWR-SWP feels that gaming opportunities, i.e. "money machine" scenarios, remain unsolved with CAISO's current design for PDR (formerly known as PDR-A). As presented by G. Muir Davis of Southern California Edison (SCE), of the three proposed methods to reduce gaming: (1) determination of a customer baseline, (2) bid price threshold, and (3) limiting Demand Response (DR) program hours, the development of reliable baselines that include all participants is still a moving target and a matter of ongoing pilot studies. Also, as mentioned by MSC Chairman Frank Wolak, utilizing baselines instead of allowing customers to react in real time to market prices will continue to be substandard and allow for gaming opportunity.

The solution is to have an identical level of settlement for Demand and DR, whether that level is at the DLAP, Sub-LAP, CLAP, or PNode. In the current proposal for PDR, Demand is bid and settled at the DLAP while DR is bid and settled at the CLAP. Per the CAISO presentation, PDR has "no requirement for underlying load associated with DR resource or program to be uniquely forecast and scheduled at CLAP"; this fact has created a "loophole." The assumed price difference between these settlement locations provides a weakness in the design that can be exploited. These problems can be resolved by eliminating the separate levels for settlement of Demand and DR.

In terms of fairness or non-discriminatory practices, allowing Demand to pay a socialized cost at the DLAP LMP and simultaneously paying or crediting DR at a nodal LMP creates buy low - sell high situations for typically high LMP load pockets and the opposite for typically low LMP areas in the same DLAP. This, in effect, is contrary to FERC Order 719 because it would discourage DR from various market participants. Under the CAISO proposal, some outlying municipal utility districts that are paying DLAP prices that are higher than nodal prices for their Demand, would only receive revenue based on nodal prices, which are lower than the DLAP prices, for their available DR.

To the extent that PDR is to be implemented, where do the funds come from to pay DR when Demand and DR are settled at disparate prices? How is revenue neutrality for the CAISO maintained in this case and what level of Demand is the impact limited to, the

DLAP, Sub-LAP, or CLAP? Financial ramifications from this version of PDR should remain the responsibility of the Demand within the applicable DLAP, or better yet the responsibility of the customers within the DR resource's relative granular level. At a minimum, Demand outside of the respective DLAP should not be affected.

CDWR-SWP believes more work by CAISO is necessary to create an acceptable design for PDR. The comparative scenarios that CAISO provided use the common caveat of theoretical conditions such as the "perfect forecast," but the CAISO should be inclined to provide better examples to account for complexities and avoid over simplification.