energyconnect

February 21, 2010

Board of Governors
California Independent System Operator
151 Blue Ravine Road
Folsom, California

Dear Governors,

On February 10, you approved a CAISO staff proposal that would modify the Local Market Power Mitigation (LMPM) procedures in connection with implementation of the Proxy Demand Resource (PDR) functionality. As staff noted, EnergyConnect was the only party that objected to its proposal. Once the staff settled on a course of action, we believed there was little else we could do to change the outcome, which is why we did not appear at the February 10 Governing Board meeting to offer comments or be available for questions.

However upon hearing of your interest and the nature of the discussion at the meeting we believe there might be some value in engaging with the Board on this topic. Our objective in writing this letter is to help inform the Board and invite any questions that remain unanswered. The stakeholder process on this issue has run its course and the Board has taken its decision. We are not in any way suggesting that the Board reconsider its decision or withdraw its approval, but we believe some of the issues we raised in our objections and repeat here remain unresolved and will be a factor in other matters that are likely to come before you in the next few years.

EnergyConnect is a demand response aggregator providing capacity, energy and ancillary services in the PJM, ISO New England, and California markets. EnergyConnect's diverse customer base includes commercial, industrial and institutional customers in these areas. While EnergyConnect provides customers with a wide variety of ways to engage in demand response, we have had notable success driving adoption of price responsive demand reduction in the PJM energy markets. It is our intent to replicate that success in California by enabling large energy users to more easily engage in price responsive demand reductions for the CAISO's energy markets.

Our objections to the CAISO's LMPM modifications are:

- To the extent it suppresses prices, LMPM will diminish incentives for demand response in precisely those locations where it has the most potential value.
- The criterion for deciding when to mitigate is based on an analysis of competitive conditions that simplistic and unjustifiably narrow in scope.
- As a matter of policy, EnergyConnect believes the CAISO must develop solutions that deal with the underlying conditions that allow parties to exercise market power. Mitigation should be the remedy of last resort that is used sparingly and only under exceptional circumstances.

Regarding the first point, customers will be motivated to provide demand response by participating in the CAISO's energy markets if the payments they receive for reducing consumption at opportune times are large enough to make participating worth their while. Not coincidentally, customers located in constrained areas of the grid that are most susceptible to exercise of market power are also more likely to participate because payments in these areas are likely to be higher than for the grid as a whole. Mitigation can reduce or eliminate payments that might otherwise be paid to participating customers if it causes generators with low default energy bids to be dispatched in front of demand response. Rather than encouraging demand response and thereby reducing or eliminating the need for mitigation, the CAISO's proposal could have the opposite effect, which is to discourage demand response and institutionalize mitigation.

Regarding the second point, our concerns about the adverse impacts of LMPM on demand response are heightened by the way in which the CAISO uses results from its Competitive Path Assessment (CPA), an analysis that is conducted periodically to decide when and how mitigation should be applied. The CPA typically examines a relatively small set of transmission paths where market results or power flow analyses have shown that congestion is most likely. If the CPA results indicate congestion on a specific transmission path could allow generators to exercise local market power, that path is deemed uncompetitive. In the CPA that was conducted for the first year of MRTU, only one of the more than 100 paths studied was identified as being uncompetitive. Under these circumstances, it is logical to assume that if most of the paths with congestion are found to be competitive, then paths with little or no congestion can also be deemed competitive without any further analysis.

CAISO staff adopted a different approach towards the paths they elected not to study that we believe to be unduly conservative. They assumed these paths are uncompetitive even though their assumption is not supported by the CPA results to date. We think the CAISO staff's treatment of these paths is not justified by the facts or the CAISO's CPA results, and it is not reasonable. As electric demand recovers along with California's economy, mitigation could be invoked more frequently simply because one or more transmission paths that were never analyzed were deemed uncompetitive for no discernible reason. As we noted earlier, frequent mitigation, particularly when it is not based on an affirmative finding, would undermine the principal motivation for customers to offer demand response in the CAISO's energy markets.

Regarding our last point, we are concerned about the lack of suitable measures other than mitigation that can be deployed to deal with exercise of market power. If lack of competition allows generators to exercise market power in the first place, then mitigation employs price controls to address the symptoms while leaving the root cause – lack of competition - untreated. Mitigation undermines incentives to build strategically located transmission, central station generation, and/or distributed resources that address the underlying competitive problem in the same way it undermines incentives for customers to provide demand response. Mitigation and other price control measures should be a last resort rather than the first and only tool that can be deployed.

Our purpose in writing this letter was to respond to the Board's stated interest in understanding our concerns about the staff's LMPM proposal in the context of PDR. We accept the Board's decision as final and are not asking that it be overturned or re-examined. We hope that by explaining our position, we have helped the Board better understand certain implications of the staff's proposal. If the Board still has unanswered questions, we would be happy to reply in writing or make a representative of EnergyConnect available to discuss them at any public meeting. Please address any written correspondence to me (rquattrini@energyconnectinc.com) and to our advisor on California ISO matters, Mr. Jack Ellis at Resero Consulting (jellis@resero.com).

Respectfully,

Rich Quattrini

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Cc: Mr. Yakout Mansour, California ISO
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