

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA**

Order Instituting Rulemaking Regarding
Policies and Protocols for Demand Response,
Load Impact Estimates, Cost-Effectiveness
Methodologies, Megawatt Goals and
Alignment with California Independent System
Operator Market Design Protocols

Rulemaking 07-01-041
(January 25, 2007)

**REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION ON THE WORKSHOP REPORTS FOR
JANUARY 19-21 REGARDING REMAINING DIRECT PARTICIPATION
ISSUES (PHASE IV, PART 2)**

The California Independent System Operator Corporation (ISO) submits these reply comments on the January 19-21 workshops and accompanying reports on demand response direct participation issues.

I. The Commission needs to ensure there is equal and non-discriminatory treatment regarding compensation between IOU and third-party demand response providers.

The ISO hopes for a workable consensus solution to settling the compensation issues between the load serving entity (LSE) and demand response provider (DRP). If the preferred compensation approach is a settlement between the LSE and DRP (versus between the LSE and the “participating” customer), then, as the ISO remarked in its comments, the Commission should ensure that the mechanics of how financial settlements are processed treat all demand response providers similarly. As CMTA/EUF stated in its comments, “the Commission should approve a design that does not create competitive advantages or disadvantages for direct access or bundled service customers. Settlements mechanisms should not tilt the playing field or provide a greater incentive for a customer to participate in PDR as either a DA or bundled service customer”. This includes the situation where the IOU is the DRP for its bundled customers.

In the final compensation analysis, assuming all things equal, no customer should benefit under the agreed-to compensation terms if demand response services are

delivered through an IOU DRP or through a third-party DRP. For instance, compensation between the IOU DRP and itself, as the LSE, could be in the form of a “charge” or cost assessed against the cost-effectiveness of the IOU run demand response program. Whatever the mechanism, the compensation approach needs to ensure a level playing field and non-discriminatory treatment between IOU DRPs and third-party DRPs offering demand response services to bundled utility customers.

II. The Commission should elect a retail settlement that incorporates the generation portion of the retail rate or a reasonable proxy rate versus the ISO Default LAP price.

EnerNOC clearly stated that it does not support a retail settlement, but remarks that “...if one were adopted, as between the two prices [DLAP or “G” the generation portion of the retail rate], G is more appropriate because it reflects the revenues lost by the IOU”. EnerNOC remarks further that “building a settlement scheme wherein the only value of direct participation in the wholesale market is based upon whether or not there is a basis differential between a DLAP price and a CLAP price, which will disappear over time, ensures that DRPs will receive *NO VALUE* for participating in PDR”.

The ISO believes EnerNOC has not overstated the faults of using Default LAP price in any retail demand response settlement. As such, the ISO recommends the Commission base any retail demand response settlement not on the Default LAP but on the generation portion of the retail rate or a reasonable proxy for this rate. Similar to PJM, the retail rate or a reasonable proxy rate could be assessed as a weighted average based on the service account rate and registered load curtailment capacity for the services accounts that make up a resource. This rate, multiplied by the resource’s performance (i.e. the ISO calculated Default Load Adjustment) could be assessed by the LSE to the DRP over the appropriate settlement interval. Again, the ISO believes simplification and compromise can be reached to best approximate the generation portion of the retail rate for participating customers that take service under different rate structures.

III. Capacity payments for demand response are essential but remain under the purview of the local regulatory authority.

The ISO agrees with EnerNOC's concern that direct participation of demand response in the wholesale market without a capacity payment is problematic and why EnerNOC "...does not currently see the value proposition of participation in the CAISO's Proxy Demand Resource (PDR) in relation to its current contracts with utilities". EnerNOC goes on to state that "[t]he CAISO's PDR does not provide a capacity payment nor does it recognize DR as providing a contribution toward resource adequacy". The ISO has strongly supported and advocated the Commission ensure wholesale demand response resources have equal access, like supply side resources, to resource adequacy capacity payments. However, contrary to EnerNOC's assertion, this decision does not rest with the ISO but with the Commission.

As EnerNOC conveyed, without resource adequacy capacity payments, the ISO believes it will be very difficult for a competitive demand response delivery paradigm to develop in California, especially given a demand resource generally provides energy service for a minimal number of hours per year, limiting total energy rents. Additional value for direct participating demand resources must come from resource adequacy capacity payments and through long-term procurement mechanisms. However, beyond access to resource adequacy capacity payments, the ISO would conclude that there are more significant structural and regulatory challenges to overcome before third-party demand response providers can likely compete and earn sufficient compensation to provide demand response services in California in a significant way. For instance, even if a third-party demand response provider had access to short-term resource adequacy capacity payments, the existing regulatory paradigm of valuing utility demand response programs on a long-term avoided generation capacity cost means utility demand response programs can justify a higher capacity payment than what is likely justifiable based on resource adequacy value. The Commission should continue its efforts to assess longer term how to reduce or eliminate these sorts of barriers, including the competitive procurement of all demand response, to support the development of a healthy and sustainable competitive third-party demand response delivery paradigm.

IV. All dispatchable retail demand response programs that qualify as resource adequacy capacity must integrate into the wholesale market when the ISO develops, and FERC approves, the standard capacity product for demand response.

EnerNOC also raises some important, fundamental questions that should be addressed by the Commission and considered in light of FERC's order for the ISO to develop a standard capacity product for demand response that qualifies as resource adequacy capacity under the ISO tariff. Specifically, EnerNOC asks, "Does the Commission intend to replace existing retail programs with direct participation? Does the Commission intend to continue direct participation and retail programs in tandem? Does the Commission intend to encourage competition for demand response services?"

To address these questions, the ISO encourages the Commission and stakeholders to consider the impact a standard capacity product will have on demand response that qualifies as resource adequacy capacity. The actual availability of demand response resources counting as resource adequacy capacity must fulfill the objective of the resource adequacy program which is to ensure that adequate resources are available when and where needed. Their availability will be subject to incentives contained in the applicable and to be determined standard capacity product provisions. In order to prepare for the application of standard capacity product to demand response, the ISO proposes that the Commission take steps to ensure that retail demand response programs that are intended to count for resource adequacy are making the transition necessary to fully integrate into the wholesale electricity market. Retail demand response programs will need to be configured to operate in the ISO market under the standard capacity availability provisions. Retail demand response programs that cannot be configured to operate under the standard capacity provisions will not meet the resource adequacy capacity requirements under the ISO tariff since the ISO tariff does not extend jurisdiction beyond wholesale products to retail demand response programs. Thus, the Commission should outline a clear path for resource adequacy qualifying retail demand response programs to integrate into ISO markets.

V. Dispatchable demand resources, like proxy demand resources, are modeled and operate in the ISO market the same as a supply resource.

EnerNOC states that “[w]ithout DR, increasing demand pushes the ISO further up the supply curve to dispatch the next generation resource. DR blunts the march up the supply curve by offering curtailment as a replacement for supply”. For clarification, proxy demand resources are modeled as generators in the ISO system and their bids are incorporated into the ISO’s overall supply curve. Thus, proxy demand resources represent additional “supply resources,” resulting in the greater depth and liquidity of supply. But, it is important to understand that both demand resources and generators sit on the same supply curve in the ISO market. Thus, additional generation can have the same effect as additional demand resources given that more, competitively bid resources, generally, result in greater price pressure and, therefore, can slow the escalation of prices as the ISO has more resources to dispatch/commit on the supply curve.

VI. The ISO supports PG&E’s recommendation for the Commission to establish working groups and a timeline for resolution of identified issues.

The Commission should set forth clear policy directions on the first and second order policy decisions in this proceeding – whether or not there should be a retail financial settlement associated with wholesale demand response participation, and if so, what is the amount or proxy cost component and how should those costs should be allocated. With Commission guidance, the ISO supports PG&E’s recommendation for the Commission to direct parties to form working group(s) to resolve issues within a given timeframe, in anticipation of resolution of assigned tasks and a decision on the key issues prior to summer 2012.

CONCLUSION

The ISO appreciates the opportunity to provide these reply comments on the workshop phase of this proceeding.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that on February 18, 2011 I served, on the Service List for Proceeding R.07-01-041, by electronic mail and United States mail, a copy of the foregoing Comments of the California Independent System Operator Corporation on the Workshop Reports for January 19-21 Regarding Remaining Direct Participation Issues (Phase IV, Part 2)

Executed on February 18, 2011 at
Folsom, California

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