



For Immediate Release

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Inappropriately administered demand response programs can increase energy costs to consumers, according to a study by LEI

BOSTON, June 21, 2010 - Increasing levels of demand response ("DR") can increase costs to consumers if system operators fail to dispatch according to least cost, according to a study by London Economics International, LLC ("LEI"). DR programs compensate consumers willing to reduce load in return for specified payments. Such programs have become widespread based on the perception that lower demand leads to lower prices and lower costs. However, allowing DR to compete against conventional generation resources on an equal basis can affect investment decisions and market prices in unintended ways in the long term, particularly if DR is not treated the same way as conventional generation during dispatch. As shown by LEI in its case study analysis of the New England wholesale power market, the development of close to 2,000 MW of active DR in lieu of conventional peaking generation raises annual average energy prices by about \$2/MWh, which implies an annual energy cost of \$300 million to NE ratepayers.

"Many system operators fail to dispatch DR according to economic principles, but regardless of the DR price bid, the operators refuse to access DR due to engineering protocols which only allow it to be used as a last resort," noted Julia Frayer, managing director for LEI. "If system operators dispatch more expensive generation when a lower priced DR resource is available, DR programs will fail to achieve their objectives, and ultimately distort investment decisions. This may harm reliability over the long term." Ms. Frayer added that while DR can provide benefits, if DR is provided capacity payments, it needs to be treated as a direct equivalent to generation.

On behalf of LEI, Ms. Frayer presented an analytical approach to study long-term impacts of DR resources at the 33rd International Association for Energy Economics ("IAEE") Conference in Rio de Janeiro, Brazil in early June, 2010. The results suggest that increasing DR can lead to higher energy prices and higher energy costs for consumers, if DR is dispatched less frequently than conventional peakers but receives equivalent payments. Furthermore, over a 20 year time horizon, the existence of active DR programs can materially delay the timing of conventional generation investments. While such delays may be beneficial if the postponed investment is not needed for reliability, if DR is inappropriately dispatched, costs to consumers will rise.

The study deployed LEI's proprietary electricity market simulation model - POOLMod, and focused on the New England wholesale power market to demonstrate the analytical approach. Use of LEI's analytical framework will allow policymakers to properly evaluate benefits and costs of DR incentive programs and to consider how market design features of DR can be improved to be comparable to conventional supply resources in performance.

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London Economics International LLC (LEI) is a global economic, financial, and strategic advisory professional services firm specializing in energy and infrastructure. The firm combines detailed understanding of specific network and commodity industries, such as electricity generation and distribution, water and wastewater provision, and natural gas distribution, with a suite of proprietary quantitative models to produce reliable and comprehensible results. For further information on LEI, please contact Julia Frayer at (617) 933-7200 or go to www.londoneconomics.com.

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