

**COMMENTS OF THE ALLIANCE FOR RETAIL ENERGY MARKETS ON THE
CAISO's 12/04/08 UPDATED STRAW PROPOSAL REGARDING A STANDARD
RA CAPACITY PRODUCT**

December 18, 2008

The Alliance for Retail Energy Markets (AReM)¹ believes that the CAISO's updated straw proposal for the Standard Resource Adequacy (RA) Capacity Product (SCP) is moving toward the development of a SCP that will improve the RA program. AReM's highest priority is that the SCP efforts remain on track for an early 2009 FERC Filing. With this priority in mind, AReM offers the following comments and observations for consideration.

1. Clarifying the CAISO's Role in Developing SCP

As AReM has explained previously and at the 12/11 meeting, the SCP is a commercial product that will be used by market participants to facilitate RA transactions. For this product to develop, the CAISO must incorporate the basic definition of the capacity product, including the performance standards for RA resources and associated compliance and performance incentives into the CAISO Tariff. While it is important that the Tariff amendments are comprehensive and clear, all parties acknowledge that the CAISO will, over time, modify these Tariff provisions to reflect experience gained, revised rules adopted by the Local Regulatory Authorities (LRAs), and changing needs (such as the implementation of Scarcity Pricing). Such future changes do not need to be defined now, but the impact that they will have should be addressed by requiring any modified SCP-related CAISO Tariff amendments to take effect prospectively.

As mentioned at the 12/11 meeting, the SCP is a tool for load-serving entities (LSEs) to use in transacting and complying with their RA requirements. Viewed this way, the CAISO's SCP effort should be more manageable and it should be possible to complete within the current schedule. To summarize, the CAISO's key role in this effort is to adopt Tariff amendments that set forth the basic definition of the capacity product, including performance standards for RA resources and associated compliance and performance incentives. Once done, the market will have the necessary foundation in place to develop the commercial purchase and sale confirmation tools.

2. Mandatory Obligation to Use SCP and Effectiveness Date

The CAISO has proposed that all LSEs be obligated to use the SCP for RA compliance and that the requirement would be imposed initially for the 2010 annual RA compliance filing. The mandatory use of the SCP might make RA transacting easier and more transparent. Furthermore, AReM understands that mandatory use of the SCP may be necessary to appropriately monitor and manage the SCP performance incentives that will be contained in the CAISO tariff. For instance, if a unit has sold portions of its

¹ AReM is a California non-profit mutual benefit corporation formed by electric service providers that are active in the California's direct access market. This filing represents the position of AReM, but not necessarily that of a particular member or any affiliates of its members with respect to the issues addressed herein.

capacity as RA to load serving entities that are subject to different local regulatory authorities, then the management of the performance incentives will be complicated.

There may be other reasons why a mandatory SCP is desirable and AReM would appreciate hearing more discussion about the pros and cons of a mandatory SCP. Moreover, the California Public Utilities Commission (CPUC) may have significant concerns about a mandatory SCP. AReM urges the CAISO to work with the CPUC staff so that its concerns are fully understood and resolved. For example, if the CPUC's concern is that mandatory use of the SCP will compromise its jurisdictional authority over IOU procurement, those concerns should be quickly addressed to achieve the February filing date.

Finally, while AReM does not oppose making the SCP mandatory if the CPUC concerns are addressed, it supports allowing its optional use as soon as the product is developed by the market. Assuming a February filing date, the FERC decision would be expected by April 2009 and the market could be expected to develop the SCP within one to two months. Therefore, AReM's members would plan to use the SCP, as an *option*, beginning with monthly RA compliance showings in July or August 2009.

3. Ancillary Services Must Offer Obligation

AReM agrees that an Ancillary Service (AS) must offer obligation is reasonable for RA units. However, AReM notes that the CAISO's proposal to include a must offer obligation for AS is somewhat controversial and conflicts with the CPUC's consideration of this requirement in R.08-01-025. The CAISO should endeavor to address the CPUC's concerns and, if they cannot be resolved in time for the February filing, the CAISO should defer to the CPUC and instead consider the AS change for the 2011 RA compliance year, so long as such a step does not defer the implementation of reserve scarcity pricing.

4. Single Performance Standard Based on Fleet Average

AReM supports the CAISO's approach of adopting a single performance standard. The discussion at the 12/11 meeting of how it would apply to wind and use-limited resources indicated that it may be a workable approach. Still, it would be helpful for the CAISO to provide some examples of how wind resources would be treated under various scenarios. In addition, AReM continues to question whether it is appropriate for resources to meet a performance standard (and be penalized if they fail), if the Net Qualifying Capacity (NQC) of those units is already adjusted based on historical output. As AReM has noted throughout this proceeding, it is inappropriate to reduce a unit's prospective NQC based on historical output AND assess in-period penalties. Therefore, AReM believes that the CAISO proposal should provide more specificity about these resources.

5. Peak Hours vs. All Hours – AReM proposes to modify the definition of peak hours proposed by the CAISO. The Updated Straw Proposal includes more than a thousand “peak hours” in the availability definition. Instead, AReM recommends defining peak hours to include several hundred hours, such as 500 hours. AReM also suggests that the CAISO develop several examples of how the incentives and charges would be applied under different assumptions about availability and performance.

In addition, AReM recognizes that RA is a monthly product in California, and that assigning some value to the off-peak months by using an all-hours metric may be appropriate. Under this approach, which is similar to the availability metric of the CFCM design, the availability rate could be determined by assigning 80 or 85 percent of the value to the summer peak hours, with 15% or 20 percent to the “all hours” availability during the off-peak months.

6. Measuring Capacity Offers for Imports and LD Contracts – AReM supports the CAISO’s proposal to measure performance for Imports and LD Contracts by tracking offers of capacity into the market and treating their failure to offer the same way failure to be available is treated for internal resources.

7. Measuring Performance of Demand Response (DR) -- As noted above in item 4, DR resources have an NQC adjusted based on historical output and, consequently, an additional performance standard may not be appropriate. If the CAISO decides to move forward with a performance standard for DR resources, AReM urges the CAISO to develop a mechanism to ensure that performance metrics for DR resources are equivalent to the performance metrics applicable to other RA resources. It would be helpful if the CAISO could provide an example of how this would work. As an alternative approach, AReM suggests that the CAISO consider treating DR resources (that are also RA resources) like imports and track their offers of capacity into the markets.

8. Grandfathering Existing RA Contracts – AReM notes again that grandfathering is not an issue specific to the development of the SCP, but rather an issue that arises whenever the CAISO changes requirements in its Tariff. Nonetheless, if some existing RA contracts still require grandfathering, AReM suggests adopting the approach used to address grandfathering for RA import allocations, which included a date certain beyond which all contracts must comply with the Tariff requirements and provided that grandfathering was limited to the duration of the *initial* RA contract term. Furthermore, market participants that have existing multi-year contracts should be encouraged to develop modifications or amendments to their existing contracts that will make them compliant with the SCP product requirements, if that can be accomplished in a commercially reasonable manner.

9. Financial Penalty Based on RA Backstop Price – As noted above, AReM can support a performance standard that provides financial incentives for performance instead of adopting a prospective adjustment to the NQC. AReM also concurs that the performance incentive price should be consistent with the prevailing capacity payment for the backstop RA procurement by the CAISO.²

10. Penalties and Self-Funding of Bonuses – Payment of bonuses requires a reasonable funding mechanism. AReM agrees that self-funding would be the least costly approach for customers. AReM supports suggestions at the 12/11 meeting to cap the size of the bonus to an individual supplier and to allow dollars to accumulate over some period of time to provide more likelihood that a bonus pool develops.

² In addition, the same RA performance standards should apply to RA backstop resources as well as to RMR resources used for RA backstop.

11. Penalty Calculation and Dead Band – AReM supports the CAISO’s proposed penalty calculation and is not opposed to the “dead band.” AReM assumes that the penalty would kick in beyond the “dead band.” This point needs to be clarified in the CAISO’s proposal.

12. No Credit Requirements – AReM supports the position in the CAISO’s 12/4 draft that the SCP-related Tariff amendments require no changes to the current MRTU credit requirements. Unfortunately, the CAISO changed its position by the 12/11 meeting. AReM continues to request that the CAISO explain whether this obligation to post additional credit applies similarly to other MRTU Tariff provisions that involve penalties.

13. Unit Substitution – AReM finds this concept to be reasonable but wonders why the extensive “pre-approval process” is required or whether a simpler approach could be adopted. AReM looks forward to reviewing proposals from RA suppliers on this point.

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On Behalf of AReM