

CALIFORNIA ISO
COST ALLOCATION GUIDING PRINCIPLES
Draft Final Proposal

**COMMENTS OF THE STAFF OF THE CALIFORNIA PUBLIC UTILITIES
COMMISSION**

* * * * *

March 29, 2012

The Staff of the California Public Utilities Commission (“CPUC Staff”) welcomes this opportunity to comment on the California Independent System Operator’s (“CAISO”) March 15, 2012 “*Cost Allocation Guiding Principles Draft Final Proposal.*”

1. Principles of “Causation,” “Incentivize Behavior” and “Manageable” Promoting Market Efficiency Should be Balanced with a Principle of Policy Alignment.

Among the proposed cost allocation principles, three efficiency oriented principles, “causation”, “incentivize behavior” and “manageable” taken together would promote allocating costs (1) to parties who cause or benefit from activity giving rise to the costs, (2) in a manner designed to incentivize efficient and desirable behavior by those parties, while (3) recognizing that to achieve the desired outcome those parties must have reasonable ability to physically and economically make the desired response. The prior draft (Feb. 14, 2012 straw proposal) of the cost allocation principles proposal also contained a principle of “policy alignment” that the CPUC Staff believes is a critical counterbalancing principle that should be part of the cost allocation guiding principles. The CPUC Staff comments recommended certain refinements to this principle to recognize that cost allocation should not be applied in a way that thwarts California and Federal energy policy objectives.¹ For example, certain policy objectives (e.g., reducing greenhouse gas emissions, reduced reliance on fossil fuels) are not automatically

¹ Comments of the Staff of the California Public Utilities Commission on the February 14, 2012 Straw Proposal, dated March 1, 2012 (Cost Allocation Guiding Principles).

achieved through short run energy market signals. On the other hand, we also have recognized that it is undesirable to pursue policy objectives in a manner that is economically inefficient. Therefore, the multiple efficiency-oriented principles and the Policy Alignment principle are *all* necessary, and together provide a needed balance.

Unfortunately, the CAISO's current Draft Final Proposal has renamed and edited the "policy alignment" principle – dubbing it "accurate price signals." This change in nomenclature and content loses the essence of "policy alignment" and adds nothing to what is already captured through the three original efficiency-oriented principles. It is important, and based on discussion in the latest stakeholder meeting appears to be generally recognized, that California and federal energy and environmental policy objectives will in fact inform and need to be reasonably accommodated by any specific cost allocations developed going forward. Accordingly, the CPUC Staff strongly urge the CAISO to reinstate and include in the final cost allocation principles a "policy alignment" principle of the type that was previously supported by the CPUC Staff. If the cost allocation guiding principles are to *actually* be used and useful for facilitating future discussions and market enhancements regarding allocation of costs for grid-related services, then they must realistically recognize policy considerations.

2. *The CAISO Should Refine the "Manageable" Principle.*

The final draft proposal modifies the "manageable" principle to emphasize transparency and a potential need to provide transition periods since current commercial arrangements may not provide flexibility for managing new kinds of costs. However, this principle should also recognize that there may be (and usually are) multiple *long run*, and not just transitional, ways to allocate costs while respecting the "causation" and "incentivize behavior" principles. In such instances the allocation method that most pragmatically and manageably leads to efficient behavior may be preferred. This is, after all, a major reason for having a separate "manageable" principle.

3. *The CAISO Should Add a "Transparency and Disclosure" Guiding Principle, or Else Fully Incorporate this into the Rational Principle.*

The CPUC Staff's comments on the straw proposal advocated for an additional principle of "transparency and disclosure" regarding the CAISO's monitoring, disclosure and analysis of the efficiency of procurement and deployment of services for which costs are being allocated.

The draft final proposal does not consider or address this request at all, and the CPUC Staff once again emphasizes that such a principle is important and should be included among the final cost allocation guiding principles.

Because the CAISO has not provided any reason for declining to include this additional principle, the CPUC Staff can only assume that the CAISO would argue that such a principle is inherently considered in initiatives that result in procurement of services whose costs need to be allocated. But this is not a sufficient basis for omission and it could reasonably be said that other cost allocation principles such as “cost causation” and “incentivize behavior” can *also* be taken for granted in this way. Indeed, the CAISO has recognized in the Flexible Ramping Product Cost Allocation Straw Proposal the importance and necessity for the CAISO to monitor and revise the amounts of services the CAISO is procuring:

Over time, the ISO will utilize the hourly profiles submitted by renewable resources to refine the procurement target for flexible ramping up and flexible ramping down. This is consistent with the Cost Causation, Incentivizing Behavior and Manageable guiding principles.²

Such revisions and underlying information should be disclosed to market participants, and would be more consistent with a "transparency and disclosure" principle than shoehorning such an issue into the three efficiency principles.

At the very least, if the CAISO does not recognize “transparency and disclosure as a separate principle, it should be expressly included in the “rational” principle, since one aspect of the rationality of a cost allocation method is the rationality and efficiency of the overall loop of procuring services, deploying services, paying for services, and allocating the resulting costs. This cannot be achieved without transparency, disclosure and analysis of the market service in question. The “rational” principle as currently proposed states that “[o]ther market design changes must be identified and considered that can also achieve the desired outcome.” This inherently requires transparency, disclosure and analysis.

Contact:

Ed Charkowicz, ed.charkowicz@cpuc.ca.gov

Keith D. White, kwh@cpuc.ca.gov

William Dietrich, william.dietrich@cpuc.ca.gov

Candace Morey, cjm@cpuc.ca.gov

² CAISO Flexible Ramping Product Cost Allocation Straw Proposal, March 15, 2012, p. 8