

Stakeholder Comments Template

Subject: Updating Interim Capacity Procurement Mechanism And Exceptional Dispatch Pricing and Bid Mitigation

| Submitted By | Company | Date Submitted |
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This template has been created to help stakeholders submit written comments on topics related to the June 9, 2010 “Updating Interim Capacity Procurement Mechanism and Exceptional Dispatch Pricing and Bid Mitigation” Issue Paper and June 16, 2010 stakeholder conference call. The Issue Paper and information regarding this stakeholder initiative can be found at <http://www.caiso.com/27ae/27ae96bd2e00.html>.

Please submit your comments on the items listed below in Microsoft Word to bmcallister@caiso.com no later than the close of business on June 23, 2010.

Your comments on any aspect of this stakeholder initiative are welcome. The comments received will assist the ISO with developing a straw proposal.

Interim Capacity Procurement Mechanism

1. Please provide your thoughts on the duration of the tariff provisions associated with a successor to the Interim Capacity Procurement Mechanism (“ICPM”) and whether the tariff provisions should be permanent, i.e. there would not be a sunset date, or have some specified termination date. If you have a specific proposal, please provide it and indicate the reasons for your proposal.

The CPUC Staff believe that the State’s current energy market design benefits from the CAISO’s having a mechanism by which to procure backstop capacity in the event that Load Serving Entities (LSEs) operating within the CAISO fail to procure the commitment of adequate resources in a timely fashion, or when extreme, unanticipated circumstances change fundamental assumptions about the grid’s operation upon which LSEs’ CPUC-regulated Resource Adequacy requirements and Long-Term Procurement Plans were based.

The CPUC Staff believe that CAISO short-term backstop procurement mechanisms, such as Exceptional Dispatch (ED), the Interim Capacity Procurement Mechanism (ICPM) and their successors, are also inherently interrelated with the CPUC's long-term procurement activities and oversight of the bulk of California's retail electricity market. Existing generation units will be drawn by fundamental self-interest into higher-paying capacity markets rather than to lower-paying capacity markets. Accordingly, the FERC determined that a critical element of any backstop procurement mechanism for California is to find a carefully balanced price to promote "longer-term contracting" and avoid undue reliance on the backstop procurement mechanism, i.e., to prevent the backstop mechanism from driving or becoming the primary procurement mechanism.¹

California's various wholesale and retail energy and capacity markets are undergoing a variety of fundamental changes and developments, such as the ongoing addition of new elements to the CAISO's new Locational Marginal Pricing based Day-Ahead and Real-Time markets and California's efforts to expand the State's reliance upon renewable energy resources. Because of ongoing changes to the wholesale and retail capacity and energy markets and the potential for creating undue reliance upon short-term backstop procurement, the CPUC has previously supported inclusion of an expiration, or "sunset," date for the CAISO backstop mechanism, such as that included in the ICPM. A sunset date may facilitate the State's ability to select and maintain an appropriate level and cost reliability (e.g., adequacy) of energy supply within the State² by requiring intermittent review and reevaluation of backstop procurement mechanisms to assure they are consonant with developments in the various wholesale and retail energy, and capacity markets.

Specifically, the CPUC Staff are concerned that as new features are implemented and circumstances change in California's wholesale and retail energy and capacity markets, significant modifications to backstop capacity procurement policy may be required and the tariff may become obsolete and/or inappropriate in a relatively short period of time. New developments include, but are not limited to, convergence bidding, Resource Adequacy Capacity market developments, the impact of the 20% and 33% Renewable Portfolio Standard (RPS) goals, and incorporation of increased Demand Response resources).

The CPUC Staff suggest that the CPUC's Resource Adequacy (RA) program and the CAISO's Standard Capacity Product have demonstrated the ability of the CPUC and the CAISO to react in concert to changes in the grid and markets, and

¹ *Indep. Energy Producers Ass'n v. Cal. Indep. Sys. Operator Corp.*, 118 FERC ¶ 61,096, at p. 61,475 (2007).

² See Section 215 of the Federal Power Act, which facilitates creation of electricity reliability organizations to promote reliability of bulk power systems, expressly retains State authority to assure reliability (e.g., adequacy) of energy supply within the State. (16 U.S.C. § 824o (i).)

the increasingly refined needs for local and system reliability and operations. The FERC's ongoing VERs Proposed Rulemaking and the CAISO's expected increased operational knowledge associated with changes to both the supply and load elements of California's changing markets suggest that a mechanism to revisit the ICPM in the near future is prudent. Thus, the CPUC Staff urge that including a sunset provision in the proposed ICPM replacement product in two years may provide a mechanism to keep the backstop capacity procurement mechanism relevant to the markets and grid conditions as they develop over time.

2. Please provide your thoughts regarding the compensation that should be paid for capacity procured under ICPM and Exceptional Dispatch. If you have a specific proposal, please provide it and indicate the reasons for your proposal.

As discussed above, the CPUC Staff agree with the FERC that the CPUC's Long-Term Procurement Planning processes, Resource Adequacy Capacity, RPS and other procurement activities should be the primary capacity procurement mechanisms for CPUC jurisdictional load, rather than CAISO-operated backstop procurement mechanisms. The CPUC Staff do not see evidence supporting any change in the compensation for ED and ICPM (or its successor mechanism).

As was the case when the ICPM was established, California currently has excess capacity. The economic decline since the design of the ICPM has exacerbated and extended this period of excess capacity. The CPUC's RA program is designed with a soft price cap to allow the price of System and Local RA products to rise along with the scarcity of such resources. Accordingly, raising prices for ICPM capacity at this time continues to risk the distortion of the State's RA market.

The CPUC Staff suggest that it is not necessary at this time to lower the ICPM compensation because, as administered by the CAISO, the ICPM does not appear to be adversely affecting the price of RA capacity in the CPUC's RA program. The CPUC Staff caution that should changes (i.e., expansion) of the duration of ICPM commitment or increases in the frequency of ICPM designations occur, it may be necessary to revisit the compensation level for ICPM to ensure the ICPM does not distort prices for RA capacity.

The CPUC Staff understand that some parties may urge the CAISO to establish a capacity payment price that is higher than current values, or that approaches the Cost Of New Entry (CONE). The FERC has already instructed that the short-

term function of ED and ICPM-type capacity payments are not designed to incent the construction of new generation, and should therefore be lower than the CONE. The CPUC Staff thus urge the CAISO to ignore any such suggestions.

3. Please provide your thoughts on the ISO's suggestion to broaden ICPM procurement authority through creation of a new category that would allow the ISO to procure capacity for up to 12 months in order to make resources with operational characteristics that are needed to reliably operate the electric grid available to the ISO.

As discussed above, State commissions such as the CPUC are intended by the Congress to be the primary source of long-term energy supply portfolio planning and procurement. The CAISO has acknowledged that part of its mission is to reduce and avoid CAISO out of market capacity procurement. In order to facilitate the reduction of CAISO out of market capacity procurement, the CPUC implemented System RA capacity procurement requirements in 2006, then added the Local Capacity Requirements and Zonal Constraints to reflect CAISO-identified transmission constraints. The CPUC has also implemented the Cost Allocation Method to fund the building of generation that is expected to be needed for California across a 10-year planning horizon. The CPUC Staff expect that further developments in the CPUC's RA and other long-term procurement programs may be warranted by wholesale and retail energy and capacity market and grid changes over time. The CPUC Staff expect to work synergistically with the CAISO to keep California's energy supply safe, stable and reasonably priced.

The CPUC Staff question what capacity needs to be secured by the CAISO for 12 months that could not be addressed through use of the current or modified RA or other CPUC procurement programs? The CPUC Staff question why the current 30-day ICPM award could not be renewed for successive 30-day periods if certain backstop capacity must be procured for short-term reliability reasons? Further, the CPUC Staff are concerned that the opportunity for a year-long ICPM-type contract from the CAISO may lure generators away from the CPUC's RA capacity program, especially those generators with local (or another type of) market power. In sum, the CPUC Staff are concerned that creating a 12-month product would tend to expand CAISO out of market procurement, rather than informing the CPUC processes which could be modified to fulfill the CAISO's operational needs.

The CPUC Staff expect that the increased diversity of renewable resources and technologies to facilitate the integration of new resources, increased demand response, Smart grid technologies, and electric vehicles may change the CAISO's operational needs in the near future. The CPUC Staff understand that

the CAISO is currently engaging in a thorough analysis of its expected operational needs to accommodate the integration of renewable resources sufficient to supply 33% of California's energy needs. The CPUC Staff support this analysis and looks forward to continued coordination with the CAISO.

4. Please provide your thoughts on the ISO's suggestion to modify the criteria that would be used for choosing a resource to procure under ICPM from among various eligible resources so that it recognizes characteristics such as dispatchability and other operational characteristics that enhance reliable operations.

The CPUC Staff support the CAISO's efforts to effectively maintain short-term grid reliability. The CPUC Staff believe that, by definition, backstop capacity procurement should only be awarded to resources to fulfill the operational needs that give rise to the backstop capacity designation. As acknowledged by the FERC, it is a State or Local Regulatory Authority's long-term capacity procurement program that should address the addition of needed generation, and presumably the characteristics and/or location of such generation, rather than the CAISO's short-term procurement mechanisms.

The CPUC Staff request further discussion of the generation criteria the CAISO may deem necessary for reliable grid operation, and the analysis supporting the selection of the criteria. The existing market design and construct was intended to provide the CAISO system with a market that would enhance reliable operation. The CPUC Staff anticipate that if and as the CAISO identifies operational deficiencies, the CPUC will adapt its procurement programs to reflect such operational needs so that the CAISO may avoid out of market procurement. If such short-term out of market procurement for specific generation characteristics were necessary, the CPUC would expect such needs to be clearly identifiable in advance, quantifiable, and consistent with the CPUC's Planning Reserve Margin as well as NERC and WECC reliability criteria. The CPUC Staff has not formally requested that the CAISO increase the detail provided in its ICPM reports, but believe that the current suggestion of increased criteria for ICPM-type designations calls for a more granular analysis. The CPUC Staff believe that the current single page reports of ICPM designations should be replaced with more detailed reports that indicate in detail the step-by-step process that resulted in the ICPM designation of a particular unit. Improvements to this process will provide stakeholders with a greater level of comfort with what, in a worst case scenario, can result in designation of specific units by CAISO operators in a decidedly non-market-based mechanism. These operational and transparency improvements become much more important as the CAISO considers increasing the duration or frequency of ICPM designations.

5. Please provide your thoughts on the appropriate treatment of resources that may be procured through Exceptional Dispatch but then go out on Planned Outage during the period for which the resource has been procured. If you have a specific proposal, please provide it and indicate the reasons for your proposal.

The CPUC Staff agree that it is not appropriate to pay a resource for 30 days if it is not available for the full 30 days. The CPUC Staff support exploring both of the proposed compensation options.

6. If you would like to identify other issues that you believe should be discussed in this stakeholder initiative, please discuss those issues here.

The CPUC Staff appreciate the CAISO's efforts to prepare for the replacement of the ICPM, and to integrate this replacement with its upcoming grid management challenges. Although the CPUC Staff are not entirely opposed to modifications to the current ED and ICPM programs, the CPUC Staff are resistant to changing a system that has effectively transitioned the CAISO through a tremendous market redesign with negligible market disruption.

As discussed above, the CPUC Staff believe that the current single page reports on ICPM designations should be replaced with more detailed reports that indicate in detail the step-by-step process that resulted in the ICPM designation of a particular unit. Improvements to this process will provide stakeholders with a greater level of comfort with what, in a worst case scenario, can result in designation of specific units by CAISO operators in a decidedly non-market-based mechanism. These operational and transparency improvements become much more important as the CAISO considers increasing the duration or frequency of ICPM designations.

Exceptional Dispatch

7. Please provide your thoughts on what fair compensation is for non-Resource Adequacy, Reliability Must-Run Contract or ICPM capacity that is Exceptionally Dispatched.

The CPUC Staff support the current compensation system, and, as discussed above with respect to ICPM, does not see significant reason to disrupt the balance already achieved. The CPUC Staff understand that a variety of initial challenges in the operation of the MRTU market have been addressed by

modifications to grid modeling and systems for development of dispatch orders, such as the Minimum Operating Constraint limitations. The CPUC Staff expect that the CAISO will continue to improve its models and dispatch systems to avoid inefficient or undesirable EDs. Thus, modifications to the current ED system are not clearly necessary.

8. Please provide your thoughts on whether energy bids for resources dispatched under Exceptional Dispatch should continue to be mitigated under certain circumstances. If you have a specific proposal, please provide it, and indicate the reasons for your proposal.

The CPUC Staff believe that ED bids should be mitigated under certain circumstances. The CPUC Staff are concerned that without mitigation, locally constrained generation units will be able to exercise excessive market power in their bidding. The lack of documented abuse of market power may be evidence the strength of the current mitigation rules.

9. Please provide your thoughts on whether to change the categories of bids subject to mitigation under Exceptional Dispatch (Targeted, Limited and FERC Approved) and whether to extend the bid mitigation for the existing categories.

The CPUC Staff would like more information on what sort of changes are to be considered, and what the effect convergence bidding would have on this aspect of the proposal.

10. If you would like to identify other issues that you believe should be discussed in this stakeholder initiative, please discuss those issues here.

Other

11. Please provide any additional comments regarding any other topic that your want to address.