Stakeholder Comments Template

Subject: Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch

Submitted by	Company	Date Submitted
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This template was created to help stakeholders structure their written comments on topics related to the August 16, 2010 Draft Final Proposal for Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch. Please submit comments (in MS Word) to bmcallister@caiso.com no later than the close of business on September 3, 2010.

Please add your comments below where indicated. Your comments on any aspect of the proposal are welcome. If you provide a preferred approach for a particular topic, your comments will be most useful if you provide the reasons and the business case.

Overall Proposal

1. **Whether you support the overall proposal.**

   CPUC staff recognizes the need for a successor mechanism to the current Interim Capacity Procurement Mechanism ("ICPM") and generally supports the CAISO's proposal to extend the existing ICPM backstop mechanism in a manner consistent with its current backstop authority, which includes backstopping the CPUC's Resource Adequacy ("RA") program, backstopping for Significant Events, and Exceptional Dispatches.

The CPUC staff does not support portions of the Draft Final Proposal that would expand the CAISO's backstop authority to provide for an up to one-year capacity procurement mechanism ("CPM") designation for resources that the CAISO believes are "at-risk of retirement" due to lack of commercial viability. The CPUC staff also opposes any expansive interpretation of the existing "Significant Event" tariff authority.

2. **Whether the proposal strikes the appropriate balance among difficult issues.**

   The CAISO's proposal attempts to balance the various and competing interests of its stakeholders; rather than attempt to answer this general question, CPUC staff believes its comments on individual issues are more instructive.

<u>Capacity Procurement Mechanism ("CPM")</u>

3. **Whether the tariff provisions should have a specific sunset date or be open-ended.**

CPUC staff continues to support a sunset date of two years for the CAISO backstop mechanism. This will allow for intermittent review and reevaluation of the backstop, and modification and/or updating as needed.

4. **The ability to procure capacity for planned transmission and generator outages or sustained, significant less-than-planned-output of intermittent resources.**

   The CAISO's initial Straw Proposal proposed new backstop authority categories (of 30-day duration), covering: (1) procurement for planned transmission or generation maintenance outages; and (2) backstop for significantly less-than-planned output from intermittent RA resources. In the Final Draft Proposal, the CAISO has determined that these two new categories are already within its tariff authority through existing ICPM or Exceptional Dispatch provisions.

   While the CPUC staff is pleased that the CAISO has recognized that there is no need for a distinct and separate backstop product to address these categories, the CAISO's conclusion that these are covered by the Significant Event Criteria is troubling. The CAISO's Significant Event tariff language (generally stated) proscribes that backstop of non-RA resources must be for a substantial event, resulting in a material difference from what was assumed in the RA program capacity requirements, or a material change in system conditions that results in a threat to reliability criteria. (CAISO Tariff Section 43; FERC ICPM Order, 125 FERC 61,053, at ¶ 71 (2009)).

CPUC staff reiterates its previous comments that planned outages are within the CAISO's control and that capacity replacement for planned generator outages should be the obligation of the generator going on outage as should the costs associated with them. As discussed in CPUC staff's comments in the concurrent Replacement Requirement for Generation Outages stakeholder process, the CAISO's backstop authority for planned outages is proscribed by a very detailed set of criteria, and should be limited to instances where there has been replacement capacity offered and rejected by the CAISO or where a generator has failed to offer replacement capacity.

Additionally, the CAISO should not adopt any CPM that risks expanding the CPUC-determined Planning Reserve Margin ("PRM"). The CAISO's stakeholder processes, a number of studies, and the CPUC Long Term Planning Process are addressing needs due to integrating intermittent renewable generation, and thus there is no immediate need for a backstop product to address intermittent resources before the outcome of these proceedings. Moreover, the CAISO's recent recently released Integration of Renewable Resources study (August 31, 2010) indicates that we have adequate firming capacity to achieve 20% renewables; therefore it appears unnecessary to design a tool to fill a need that has not yet been identified.

5. **The proposed treatment of procured capacity that subsequently goes out on planned outage during the period for which the capacity has been procured.**

CPUC staff supports the proposal to reduce payments to resources under a CPM designation that go on a planned outage during the time of its CPM designation. CPUC staff notes that the outcome of the CPM Final Proposal should be coordinated with the CAISO's Replacement Requirement for Generation Outages stakeholder process, and should allow the option for a CPM-designated unit to submit replacement capacity in the event that the generator goes on a planned maintenance outage, thereby avoiding the deduction in their CPM payments. In the event that a CPM-designated unit is unable to provide replacement capacity, the supplier (already procured as a consequence of reliability needs) would by definition be causing a reliability problem and the CAISO could then prorate the CPM payment by a fraction for the days on outage.

6. **Modification of the criteria under section 43.3 of the ISO tariff for selecting capacity from among eligible capacity.**

CPUC staff supports the inclusion of criteria for choosing CPM resources that properly reflect the genuine operational and reliability needs of the CAISO. The addition of these two new criteria of capacity eligible for a CPM designation, i.e., a preference for non-use-limited-resources and the ability to select for operational characteristics, will better harmonize the CPM procurement with the underlying reliability needs the CAISO identifies. In the CAISO's Replacement

Requirement for Scheduled Generation Outages stakeholder process, CPUC staff proposes that the CAISO define a clear set of reliability criteria that would trigger the CPM backstop for units on planned maintenance outages. The CPUC staff recommends that the CAISO include in the defined reliability criteria specifications for which types of reliability problems necessitate which types of CPM capacity, such that the market will know in what cases the CAISO will designate CPM for non-use limited capacity and under what reliability circumstances the CAISO will designate CPM capacity to procure certain operational characteristics. CPUC staff looks forward to working with the CAISO to develop a set of criteria for incorporation into its tariff. CPUC staff realizes the CAISO already has several sets of reliability criteria to manage and optimize, but there would be great benefit to the market to codify and integrate sets of criteria into one place and making these criteria as much as possible public information.

7. Procurement of capacity that is needed for reliability and is at risk of retirement.

Perhaps the most controversial aspect of the Straw Proposal is the CAISO's proposal (and underlying rationale) for a new backstop procurement category of up to one-year in duration to procure resources that the CAISO deems may be needed for reliability in the coming year, and are in danger of shutting down. CPUC staff continues to oppose the creation of this new category for backstop, as expressed its previous July 30th comments on this subject. Several aspects of this proposal are troubling, including jurisdictional issues, incompatibility with existing CPUC programs, the duration of the CPM designation, and the proposed compensation. (Compensation is discussed in the following question.)

In addition, as CPUC staff detailed in previous comments, the CAISO's proposal to procure backstop resources for up to one year is inconsistent with the CPUC's authority over long term planning to meet California's reliability needs. Currently, both the CPUC's RA program and Long Term Procurement Plan ("LTPP") processes have been successful in meeting reliability needs, and reducing reliance on RMR contracts. The CAISO's explanation that a CPM designation is preferable to an RMR contract because it would "contribute to a more liquid day-ahead and real-time energy market" (Draft Final Proposal, p. 24) appears to ignore the success of the LTPP program in providing adequate capacity at reasonable prices. Additionally, the CPUC and CAISO have been working together to minimize the use of RMR contracts. CPUC staff prefers the relative transparency of RMR designations to what may be a less-than-transparent procurement method in the CPM designation.

Moreover, under the General Order 167 Operating Standards 22-25, there is already a CPUC process in place whereby a generator is required to notify the CPUC if its intention to shut down or mothball, for any reason (whether it be due to "commercial viability" or other reasons). Operating Standard 24 requires generators to maintain a unit in a state of readiness for service, unless the

CPUC, in consultation with the CAISO, has determined that the unit is not needed. This standard requires that the generator be compensated for such services. This consultation process has been used in the past to successfully ensure that needed generation is kept online and adequately compensated.

The CPUC staff appreciates the additional clarifications offered in the Final Draft Proposal (p. 23), wherein the CAISO proposes to perform due diligence in assessing the financial condition of the generator, producing a report for stakeholder review, and reducing CPM payments if the resource were able to receive an RA payment. Nevertheless, for the reasons outlined above, the CPUC strongly urges against this expanded backstop authority by the CAISO to offer a one-year CPM designation as a form of incentive payment for resources about to retire.

The CPUC staff emphasizes that any CPM must allow plants to retire consistent with general economic market theory. The coordination of procurement planning and resource needs forecasted or otherwise desired at some future date by the CAISO requires careful coordination that best occurs in the Commission’s LTPP proceeding. The creation of a unique capacity-like need to which the CAISO makes market exit decisions is incompatible with the State’s environmental and other policy goals. The CPUC staff emphasizes that the Commission’s LTPP proceeding, in which the CAISO participates, will address a variety of issues, including reliability, once-through cooling retirements, renewable integration, and cost.

8. The compensation methodology for resources procured under CPM and Exceptional Dispatch.

In the Straw Proposal, the CAISO proposed two administrative payment options: Option A proposed pricing based on the Cost of New Entry (CONE); Option B was a price based on going forward fixed costs. The CPUC staff is pleased that the CAISO has removed Option A. As stated in CPUC staff’s July 30th comments, the backstop capacity compensation need not be designed to impact forward capacity prices, or elicit new investment decisions.

In previous comments, CPUC staff supported the payments based on current mechanisms, whereby the supplier receives a standardized payment (with the option of going to FERC for approval of a higher payment). In the Final Proposal, the CAISO provided additional details and support for its pricing based on Going Forward Fixed costs, resulting in a minimum capacity payment of approximately $55/kW-year. CPUC acknowledges that this price is consistent with the California Energy Commission’s recent study on Costs of Generation introduced at the August 23, 2010 workshop, but cautions that this figure risks raising prices for capacity in the Commission’s RA program if it is applied on an annual basis.

Exceptional Dispatch

1. **Linking compensation for Exceptional Dispatch to the CPM Payment.**

   CPUC staff supports the current relationship between ICPM and Exceptional Dispatch.

2. **Extending the existing bid mitigation.**

   CPUC staff supports the extension of bid mitigation for ED resources.

Other

The CPUC staff emphasizes the value of the CAISO's participation in the Commission's LTPP process and strongly encourages the CAISO to remain active in that proceeding. A CAISO policy of seeking first to resolve procurement related concerns in that forum before attempting to create new products or tools will help to ensure the success of the Commission's efforts to minimize the CAISO's need for residual backstop procurement. Such CAISO tariff-based backstop procurement may have unexpected and unintended consequences.