

Stakeholder Comments Template

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

Submitted by	Company	Date Submitted
<i>CAISO Department of Market Monitoring</i>	CAISO	<i>October 5, 2010</i>

This template has been created to help stakeholders provide their written comments on the September 15, 2010 “Revised Draft Final Proposal for Capacity Procurement Mechanism and Compensation and Bid Mitigation for Exceptional Dispatch.” Please submit comments in Microsoft Word to bmcallister@caiso.com no later than the close of business September 29, 2010.

This template is structured to assist the ISO in clearly communicating to the ISO Board of Governors your company’s position on each of the elements of the Revised Draft Final Proposal. In particular, the ISO is interested in whether your company generally supports or does not support each element of the proposal and your reasons for those positions. Please provide your comments below.

Proposal Element	Generally Support	Do not Support
1. File CPM and Exceptional Dispatch tariff provisions with no sunset date.	Support – the tariff, including the CPM price, can be revised in the future if appropriate.	
2. Provide that ICPM procurement with a term that extends beyond March 31, 2011 can be carried forward into CPM and paid at CPM rate after March 31 without doing a new CPM procurement.	Support	
3. Pro-rate the compensation paid to CPM capacity that later goes out on planned outage after being procured under CPM.	Support – it is reasonable that the CPM payment be reduced for capacity that is unavailable because of a planned outage, just as it currently is for capacity unavailable due to a forced outage.	
4. Improve current criteria for	Support – it is reasonable for	

Proposal Element	Generally Support	Do not Support
selecting from among eligible capacity for CPM procurement by adding a criterion to establish a preference for non-use-limited resources over use-limited resources.	the ISO to be able to select a non-use-limited generating unit from similar situated units.	
5. Improve current criteria for selecting from among eligible capacity for CPM procurement by adding a criterion to establish an ability to select for needed operational characteristics.	Conditionally support – see comments under “Other Comments” below.	
6. Procure capacity to allow certain planned transmission or generation maintenance to occur.	Support, but note that these circumstances appear to be already included in the “Significant Event” criteria, as the ISO notes. Also note that the ISO has broad authority to dispatch units under Exceptional Dispatch, which, if non-RA capacity is dispatched, would result in a CPM designation anyway.	
7. Procure capacity in situations where the output of intermittent Resource Adequacy resources is significantly lower than their RA values.	Support with the same comments as under 6., above.	
8. Procure capacity that is needed for reliability but is at risk of retirement.	Conditionally support – see comments under “Other Comments” below.	
9. Base compensation paid for CPM on “going-forward fixed costs” plus a 10% adder (\$55/kW-year per CEC report), or higher price filed/approved at FERC.	Support – see comments under “Other Comments” below.	
10. Compensate Exceptional Dispatch at same rate as compensation paid under CPM, or supplemental revenues	Support – all CPM designations should be paid the same rate, regardless of whether they were anticipated and	

Proposal Element	Generally Support	Do not Support
option.	designated CPM proactively or received CPM status through Exceptional Dispatch.	
11. Mitigate bids for Exceptional Dispatches: (1) to mitigate congestion on non-competitive paths, and (2) made under “Delta Dispatch” procedures.	Support – appropriate to mitigate bids under non-competitive conditions. Same as current application of mitigation for ExD.	

Other Comments

Proposal Element 5 - Adding a criterion to establish an ability to select for needed operational characteristics.

DMM supports the ability of the ISO to select among units based on specific operational characteristics when designating CPM capacity. As the ISO's Revised Draft Final Proposal notes, this may be increasingly important to respond to operational conditions as the ISO increasingly relies on renewable resources. Consequently, DMM supports the ability of the ISO to select CPM capacity based on generating unit's operational characteristics. However, the requirements that drive this characteristic-based CPM procurement should be as transparent as possible, and specified as far in advance as practical. This will not only provide information to ISO stakeholders, but also facilitate explicit use of this information in the RA and LTPP procurement process and/ or development of additional ISO market products. Given the growing emphasis and stated need for new products to accommodate increasing renewable integration, the ISO should clearly define specific operational characteristics that are needed, identify sources of these characteristics, clearly identify Exceptional Dispatch and CPM designations made for resource characteristics, and make this information available to stakeholders in a timely and useful fashion.

The issue of cost allocation was raised in the stakeholder comments in the context of resources secured under the CPM authority for purposes of meeting specific operational requirements, whether under the retirement provision, ad-hoc CPM designation, or CPM via Exceptional Dispatch. The ISO is proposing that CPM designations may be made to meet deficiencies in specific operating characteristics. This specificity allows the ISO to more narrowly define the cause of the CPM and provides an opportunity to allocate the associated costs to either (a) participants whose activities create the requirement or, in the absence of that, (b) the participants who benefit from the reliability associated with the procurement. DMM recommends that the ISO review the cost allocation of CPM in the context of the various reliability requirements that could result in a CPM designation and align the cost allocation as closely with cost causation principles. In the event a

reasonable cost causation allocation cannot be formulated, then cost allocation should be aligned with proportional benefit from the reliability resulting from the CPM designation.

Proposal Element 8 - Procure capacity that is needed for reliability but is at risk of retirement.

DMM supports providing the ISO with the ability to procure CPM capacity from a generating unit that is specifically needed for reliability, but is planned to be retired because of insufficient revenues. DMM recognizes that numerous participants have concerns about how this authority might undermine the current process of relying primarily on the RA program and LTPP to meet reliability requirements. However, DMM believes that the process for determining any CPM designations under this authority can be designed to mitigate these concerns and continue to rely primarily on bi-lateral procurement through the RA program and LTPP to meet reliability requirements. As described below, this would ensure that the CPM is a backstop of “last resort” and does not undermine the current RA and LTPP paradigm.

First, DMM notes that the ISO should seek to work with the CPUC to ensure that all reliability needs are captured in the system and local RA requirements. As noted above, any specific resource characteristics needed that may not be captured in these requirements should be identified as clearly and far in advance as possible so that they might be incorporated in RA and LTPP resource procurement decisions.

The current RA process is designed to ensure that LSEs have the opportunity to resolve any capacity deficiencies before the ISO resorts to backstop procurement. Under this process, the ISO first publishes local RA requirements and studies by the summer prior to each compliance year. LSEs then make year-ahead local RA showings by October. By early November, the ISO reviews year-ahead showings of RA capacity and identifies any additional resources or requirements that may not be met by these showings. LSEs are then provided with the opportunity to modify or supplement year-ahead RA procurement to address these deficiencies until December 1. Only then would the ISO seek to utilize its backstop authority to meet any localized requirements prior to the start of the next calendar year.

This process could be expanded to include any resource characteristic requirements not captured in local RA studies and requirements (e.g. timing prevented the incorporation into RA requirements). In addition, a similar process could be followed during the 90-day notice period for units that submit a formal request to retire. There appears to be disagreement as to the authority of the CPUC to ensure procurement of non-IOU capacity during this 90-day period under CPUC General Order 167 or other mechanisms. However, in the event the ISO determines that any capacity subject to this formal notice of retirement is needed for reliability, the ISO should clearly and early in the process provide the CPUC and LSEs with the opportunity to procure this capacity through a bi-lateral agreement prior to making any CPM designation. If, as argued by the CPUC and PG&E, the CPUC has this authority and exercises it, then the ISO will

never need to utilize the CPM under this scenario. At the same time, if this capacity is not procured bi-laterally, the ISO must have the authority to procure this capacity at the end of this 90-day period at a just and reasonable price as a backstop of “last resort.”

Having the authority to procure capacity needed for reliability as a backstop of “last resort” is an essential function of the ISO for both reliability and local market power mitigation. Numerous participants have expressed concern that the level of compensation proposed under the CPM and/or the authority of the ISO to apply the CPM to units indicating their intention of retiring may create opportunities for gaming and/or the exercise of market power. DMM believes the following considerations should allay these concerns:

- First, while the compensation proposed under the CPM would be higher than under the ISO’s current backstop procurement authority, the proposed level of compensation would provide a reasonable level of price mitigation for the local market power of existing units needed for reliability (see discussion in the section on *Proposal Element 9 – CPM Compensation Price*).
- Second, DMM is suggesting several additional refinements to the CPM provisions that can be made to address concerns of some stakeholders that, in order to receive CPM payments, generators may threaten to retire units needed for reliability that could expect to recover their going forward fixed costs without reliance on CPM payments.

Specifically, DMM suggests the following refinements could be included in CPM provisions:

- If a generating unit owner notifies the ISO that they intend to retire a unit after the 90-day notification period, the owner’s sworn statement of the unit’s financial condition must include the following:
 1. A specific statement as to the reason the unit is being retired. DMM’s understanding is that in order to be eligible for CPM under this criteria, the unit owner would need to certify that they determined that the unit’s potential net operating revenues (including any capacity payments from the bilateral market) would not cover its going forward costs.
 2. A breakout of the unit’s going forward fixed costs and supporting documentation.
 3. The owner’s calculation of net market revenues that might be earned if the unit did not retire (with supporting documentation and description of assumptions).
 4. A summary of offers made and received by the unit owner for the unit’s capacity in the bi-lateral market.

- The information above would be subject to review by DMM from several aspects:
 1. The veracity of information provided and reasonableness of analysis and conclusions; and
 2. Whether the unit owner offered the capacity at a competitive price in the bilateral market and/or whether the unit owner declined offers in the bi-lateral market that would appear to have financially supported continued operation of the unit.
- If DMM had concerns about the veracity or reasonableness of information provided or that a unit may be economic withheld from the market, then:
 1. The issue would be subject to referral to FERC; and/or
 2. DMM could recommend that modifications in market rules be made to address specific inefficiencies or market power issues observed to be occurring due to the existing market design.

This approach seems generally consistent with the role of market monitors in reviewing capacity offer prices and going forward costs for existing units in other capacity markets (such as NE-ISO and PJM), and the role of the market monitor in the capacity market approach proposed by the California Forward Capacity Market Advocates (“CFCMA”).

With this approach, a decision whether or not to retire a unit within the 90-day notice period would be necessary. If at the end of this 90-day period a unit needed for reliability was not procured by an LSE, it appears that the unit would need to be procured under the CPM, even if DMM's review indicated the matter may be subject to referral to FERC. Under this scenario, the CPM compensation may be subject to refund or adjustment based on results of any finding by FERC.

Proposal Element 9 – CPM Compensation Price

DMM supports the ISO's proposal to base CPM pricing on going forward costs, for the following reasons:

- In order for it to be economically rationale for unit to remain in operation, its net market revenues must exceed its going forward fixed costs. The proposed compensation ensure that the unit receives its going forward fixed costs (with a 10 percent adder), and keep any net market revenues earned from sales of energy and ancillary services. Thus, the proposed compensation is clearly sufficient to provide reasonable compensation of existing units that would otherwise be retired from service.
- Even if a cost of new entry price was used for the CPM, it would not provide a valuable price signal for new investment because the CPM will not be used for multi-

year capacity procurement. Without a multi-year requirement, the amount of capacity purchased is disconnected from future needs. Consequently, a given area may not be currently short on capacity, yet will be short in the future. In this circumstance, the CPM would not provide a price signal for this needed capacity until well after any new investment could respond.

Under California's current market design, investment in new capacity is driven by the LTPP and RA process. DMM acknowledges that refinements to this current paradigm may be beneficial to address issues such as: (1) the lack of a more formal multi-year RA process, (2) resource characteristics that are currently not considered in capacity pricing, and (3) lack of transparency in capacity prices.

However, the CPUC and ISO does not currently plan to pursue a formal central capacity market for either generic capacity or characteristic-specific capacity to meet future needs related to renewable integration. Since the LTPP and RA program are the vehicles for capacity procurement at this time, modifications to these processes program should be considered to ensure that portfolios of resources with the needed characteristics are procured and, presumably, that the price of capacity purchased under these processes reflects its value relative to these characteristics.