# INDEPENDENT ENERGY PRODUCERS

March 23, 2012

**To:** **CAISO**

**From:** **Steven Kelly**
Policy Director

**Date:** **March 23, 2012**
**RE:** **CAISO Cost Allocation Guiding Principles – Draft Final Proposal**

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The Independent Energy Producers Association ("IEP") is please to provide the following comments regarding the CAISO's Cost Allocation Guiding Principles Draft Final Proposal. IEP provided comments on the initial Straw Proposal, and participated in the CAISO Stakeholder Meeting on March 16, 2012; and, those comments are incorporated herein.

As a general matter, IEP appreciates the modifications made in the Draft Final Proposal compared to the Straw Proposal. The Draft Final Proposal provides helpful clarifications and changes in the CAISO's proposed Guiding Principles. While a set of Guiding Principles will be helpful in consideration of cost allocation/cost responsibility for ISO market costs going-forward, clearly "one size does not fit all" and having a guiding set of principles could be helpful in addressing matters related to costs allocation/cost responsibility.[1]

1. **Comments on Guiding Principles.** The Draft Final Cost Allocation Guiding Principles provide additional guidance to market participants when considering how best to allocate CAISO market costs. The Guiding Principles, however, will only affect future resource choices, and will have little impact on decisions already taken. Accordingly, IEP reiterates its concerns that the application of the Guiding Principles in a retroactive manner (a) will not send proper price signals to incentivize behavior where decisions have already been made, it will only make the management of existing resources that much more problematic; (b) may not result in cost allocation to those best able to manage the costs; and (c) may not properly allocate costs responsibility for CAISO market costs to those entities that bear responsibility for procurement decisions that gave rise to these costs, but rather it will reward LSEs for poor procurement practices in the past. IEP elaborates these concerns below in the response to the most recent Draft Final proposal.

    a. **Causation.** As noted in prior IEP comments, nearly all development decisions in the California today are driven by long-term power purchase agreements and/or

[1] IEP does not believe that a set of Guiding Principles need be approved by the CAISO Board at this time, as this approach may render the application of the Guiding Principles too rigid to be helpful in future discussions regarding CAISO market costs. If the Guiding Principles were to go to the CAISO Board for approval, IEP requests that advance notice be provided market participants and additional time be afforded market participants to prepare comments to the Board.

rate-based commitments for utility-owned generation. Thus, the root "cause" of poor procurement decisions rests with the LSEs and their procurement practices, rather than with the generators and their operational characteristics matched to their contractual obligations. The solution, therefore, is to incent better LSE procurement practices going-forward. To the extent that CAISO related costs should be borne by generators in order to incent better LSE procurement practices, then a reasonable means of cost-recovery for CAISO incurred costs (if any) must be made available *prior to any transition* to an environment in which such costs are imposed directly on generators. Otherwise, the CAISO risks undermining grid reliability as electric generators face costs for which they have no reasonable means of cost recovery.

IEP appreciates the CAISO's desire to apply the principle of Causation as a means to incentivize behavior. As an example, the CAISO indicates a "key tenant behind locational marginal pricing market design, in which energy prices reflect a generating unit's contribution to exacerbating or relieving transmission congestion." (p. 5) In response, IEP notes that the application of this principle relies on two facts, neither of which prevail in the CAISO's service territory today: first, locational marginal pricing must be the primary signal driving procurement decisions, which is not the case today; and, second, price signals to relieve transmission congestion must be known in advance over the term of a long-term power purchase agreement (e.g. 20 years), which is not the case today. Requiring individual generators to bear the risk of changes in the potential costs for procurement decisions made in the absence of such long-term price signals imposes an unjust and unnecessary burden on the generators. Furthermore, on a going-forward basis, it imposes unneeded additional costs on ratepayers as *all* developers will have to bid into each LSE Request for Offers ("RFO") the *risk* that these unknown and unknowable costs may be borne by their facility over the term of the long-term contract.

b. **Comparable Treatment.** IEP supports this principle. In line with the CAISO's explanation for the application of this principle, we recommend modifying slightly this principle to read as follows: "Comparable Treatment for Similarly Situated Resources."

c. **Accurate Price Signals.** IEP supports this principle. However, we note that providing accurate price signals has multiple components. First, the CAISO should help send accurate price signals to LSEs who are making the key procurement decisions that incent generator operations and/or development. Second, sending accurate price signals only makes sense the extent to which generators may respond to them. Once LSEs enter into contracts with electric generators, generators have little opportunity to modify their operations outside the terms and conditions of the contract.

d. **Incentivize Behavior.** IEP supports this principle. However, as previously noted, once LSEs enter into contracts with electric generators, generators have little opportunity to modify their operations outside the terms and conditions of the contract. The critical goal, given the nature of California's energy markets and procurement practices for the foreseeable future, is to incentivize better LSE procurement behavior.

e. **Manageable.** IEP supports this principle and believes it is the most critical principle to the success of this endeavor. As noted by the CAISO, "Market participants should have the ability to manage exposure to the allocation." This reflects a critical concern we have expressed previously in comments. In light of this concern, the CAISO recognizes "that transitional measures may need to be assessed to allow sufficient time for market participants to implement within contractual arrangements." IEP strongly supports this observation, but believes that an effective and reasonable transition is a condition precedent for moving forward with the goal of shifting CAISO market cost responsibility from LSEs to generators. [Below we provide a specific proposal to manage this transition.]

f. **Synchronized.** IEP supports this principle.

g. **Rational.** IEP supports this principle.

## 2. Proposal to Manage Transition To Environment in Which Cost Responsibility for CAISO Market Costs Shift from LSEs to Generators

LSEs were the primary drivers of the existing resource base, the vast majority of which operate under existing contracts; and, the LSEs will continue to be the key decision-makers driving future generation additions, i.e. the what, where, when.

Given the reality of this mix of resources and the continuing importance of LSE procurement practices in resource selection, IEP suggests the need for the following policy, as a *condition precedent*, to rationally move a market design in which CAISO-related market procurement costs are shifted from LSEs to generators without undermining neither existing commercial transactions nor grid reliability:

1. Currently, the LSEs bear the costs for most, if not all, the market products procured by the CAISO to maintain overall grid reliability, including backstop procurement. Continue to allocate these costs to LSEs during the transition to the new paradigm.

2. If an LSE offers a contract term providing full cost-recovery of CAISO market costs to a generator, but the generator declines accepting that contractual term; then, cost allocation shift from the LSE to the generator.

3. If an LSE offers a contract term providing full cost-recovery of CAISO market costs to a generator, and the generator accepts the contractual term; then, cost allocation will shift from the LSE to the generator upon finalization of the contract term.

Respectfully submitted,

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