INDEPENDENT ENERGY PRODUCERS

To: **CAISO**

From: **Steven Kelly, Policy Director**

Date: **February 27, 2012**
RE: **IEP Comments re CAISO Cost Allocation Guiding Principles: Straw Proposal (dated February 14, 2012)**

The Independent Energy Producers Association (IEP) offers the following comments on the CAISO Cost Allocation Guiding Principles: Straw Proposal (dated February 14, 2012). The CAISO's straw proposal presents the CAISO's proposed guiding principles for allocating ISO market costs among market participants. The proposed cost allocation guiding principles have seven elements: (1) Causation, (2) Comparable Treatment, (3) Policy Alignment, (4) Incentivize Behavior, (5) Manageable, (6) Synchronized, and (7) Rational. IEP's response to each of these principles is provided below.

Overview:
The CAISO indicates it has committed to a "holistic" review of cost allocation (p. 4). We appreciate the context. IEP is concerned, however, that the CAISO not ignore the reality that, irrespective of technology, ***generation operates to serve load***. In reality, electric generators are dispatched to meet the demands of load. In some instances, their unique operational attributes may make some electric generators "preferred resources" operationally due to various public policies objectives. Yet, the "causation" in both instances does not rest primarily with the electric generators. In the absence of demand, the generator would not operate and the CAISO would not need any of the ancillary services or backup support services it acquires. In the absence of legislatively prescribed public policy and poor utility procurement practices, the CAISO might not need flexible capacity products to integrate resources. On the other hand, current public policy, market design, and commercial realities force generation into commercially financeable contracts with load-serving entities ("LSEs") to serve that load, and these contracts have clear terms and conditions for operations and cost recovery. CPUC jurisdictional utilities are required to make procurement decisions based on a "least-cost/best-fit" ("LCBF") paradigm designed to reduce the holistic costs of generation needed to meet the demands of load in a timely and cost-effective manner consistent with state and federal public policy.

In the absence of clear contractual language in existing and/or future contracts providing for a pass-through of CAISO related costs, whatever their cause, allocating any such costs to electric generators raises a host of concerns. Allocating these charges to generators with no basis for cost recovery will impose (a) an added burden on existing contract holders who do not have a reasonable means of cost recovery, and (b) create yet another barrier to the development of new

resources, particularly those resources such as RPS, CHP, and others that are being actively encouraged as part of various public policy initiatives (e.g. RPS, AB 32, AB1613, etc.). Rather, the more efficient mechanism to implement appropriate cost-assignment for resources procured under long term contracts with LSEs is to assign these costs to the purchasing LSE for their consideration in the long term procurement process. This would be consistent with the realities of the California hybrid market structure in place today in California.

IEP Comments on the CAISO's Proposed Principles for Cost Allocation
IEP provides specific comments below in relation to each of the cost allocation principles proposed by the CAISO.

- **Causation – "Costs will be charged to resources and/or market participants that benefit from and/or drive the costs."** Today, generation development typically is supported by long-term, bilateral contracting. To facilitate this approach while ensuring that consumers realize the low-cost products commercially available, the CPUC has imposed on jurisdictional LSEs the LCBF procurement model which, in theory, should properly account for CAISO related uplift charges. In light of this procurement model, the CAISO proposal is placing generators in double-jeopardy. Equally important, the CAISO proposal is creating barriers to generation development and/or needlessly raising the costs of electric bid prices in utility RFOs due to the inherent risk factor of having to bear costs associated with CAISO actions which are inherently unknown and unknowable to the generator in advance. On the other hand, the CAISO proposes to shield the load from any direct allocation of the costs associated with generation selected by the load in the first instance. The better approach is to properly align costs with actual procurement practices; and, more critically, work with the CPUC to integrate consideration of these costs into the LCBF methodology on a going-forward and transparent basis.

- **Comparable Treatment. "Similarly situated resources and/or market participants should receive similar allocation of costs… intended to emphasize non-discrimination as well as avoiding special treatment of different types of technologies and/or market participants."** Embedded in the CAISO's principles is the assumption that all electric generators, by the mere fact that they are located within the CAISO service area, are "similarly situated." This assumption may be accurate if the sole criteria is being located within the CAISO service territory, but the assumption is erroneous when considering all the other characteristics and attributes of electric generators. No two are physically, contractually, or technically the same. By treating inherently dissimilar generation in a similar fashion, the CAISO is potentially imposing costs on components of the electric generation fleet associated with CAISO actions taken due to the failure of LSEs to procure resources cost-effectively. On the other hand, the CAISO can and should consider imposing CAISO generated costs on those entities that truly are similarly situated vis-à-vis the CAISO, namely the LSEs, making this procurement decisions; and, thereby more properly align the costs incurred by the CAISO to maintain overall grid reliability with the needs of load for which the activities are undertaken (i.e. true "cost causation").

  To reinforce the concern that the CAISO's proposal to impose a policy on similarly situated entities in a similar manner has unintended and potentially discriminatory effects, IEP adds the following concern for the CAISO's consideration. Under the current hybrid

market design in California, investor-owned utilities are allowed (often incented) to build utility-owned-generation ("UOG") to compete with independent power producers ("IPPs"). On the one hand, UOG projects are guaranteed by the CPUC cost recovery of all reasonable costs borne by the generator, including CAISO uplift charges such as proposed. This effectively makes any IOU with UOG competitive interests indifferent to the CAISO proposal as the UOG will be guaranteed to recover its costs through its rates. On the other hand, IPPs would clearly be at risk for cost recovery through a contract with an LSE (or, in the CAISO-run markets). While the CAISO proposal from one narrow perspective may appear non-discriminatory by treating all electric generators the same, the CAISO's proposal in reality works to the competitive advantage of one sector of the market based on ownership-type (i.e. UOG) versus another (e.g. IPP).

- **Policy Alignment. "… supports the economically efficient achievement of state and federal policy goals."** The principle of policy alignment begs the question: when did the legislature impose a duty on the CAISO to ensure and determine "economically efficient" public policy outcomes, specifically when that duty may well supersede and potentially undermine the clear legislative policy prescriptions imposed on various state agencies (e.g. the CPUC, CARB, and/or the CEC)? The CAISO's proposal to *allocate the costs* associated with maintaining overall grid reliability, a duty which the CAISO clearly has, would not improving overall grid reliability one iota; yet, the proposal would potentially undermine achievement of various procurement objectives clearly established by the legislature.

- **Incentivize Behavior. "Providing appropriate incentives is key to an economically efficient market."** As note elsewhere, since the CAISO's primary function is providing overall grid reliability on behalf of load, providing appropriate incentives to the load to minimize grid uplift charges seems most appropriate and consistent with this principle. Certainly, imposing additional CAISO charges on electric generators that have no reasonable means of cost recovery of those same charges provides no incentives at all.

- **Manageable.** "**The market design should seek to minimize variability and complexity of the allocation and maximize the transparency of cost drivers."** The benefits of imposing the costs of various CAISO practices, e.g. flexible capacity procurement, on generators operating under CPUC-approved PPAs is not clear. Would it enhance LSE procurement decisions or allow problems to linger?

- **Synchronized.** "**Align to selected billing determinant."** No comment.

- **Rational. "Implementation costs/complexity should not exceed the benefits…"** IEP tend to agree with the need for rational policy implementation. However, we are unsure that the putative benefits associated with imposing additional costs on preferred resources already considered in LSE procurement practices are outweighed by the negative impacts this policy would have on actually securing those same resources.

IEP appreciates the opportunity to provide these comments. We have raised a number of concerns related to the purpose and practicality of the CAISO proposal, particularly in light of the commercial and procurement realities faced by electric generators in California today. Electric generators respond to the needs of the load as expressed through LSE procurement

practices and CAISO daily locational market signals. The CAISO responds to the need of the load as expressed through daily locational market signals, forecasts of need via the CPM, etc., in order to ensure overall grid reliability. The common ingredient is the load and allocating CAISO related costs directly to the load through LSEs provides the most efficient and non-discriminatory solution in today's world.