

**Comments of
Mirant California, LLC,
Mirant Delta, LLC, and
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On Revised Standard Capacity Product Straw Proposal**

Submitted by	Company	Date Submitted
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On behalf of Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC (collectively, Mirant), we offer the following comments on the revised Standard Capacity Product (SCP) Straw Proposal prepared by CAISO staff. As discussed in previous comments, Mirant's facilities currently operate under tolling agreements that serve a resource adequacy (RA) function with terms extending to the end of 2011. Accordingly, while Mirant supports the creation of a SCP, Mirant believes that the implementation of the SCP should not interfere with existing contractual obligations of parties to RA agreements. Furthermore, Mirant believes that the CAISO should take the time necessary to ensure that any SCP proposal it adopts is fully and carefully developed, sacrificing artificial deadlines, if necessary, to meet that standard. With these overarching concerns in mind, Mirant offers the following comments on the revised SCP Straw Proposal.

Nature of SCP

As outlined in the original staff issue paper dated August 27, 2008, stakeholders, including Mirant, supported the creation of a SCP to facilitate the selling, buying and trading of capacity to meet RA requirements. Negotiating RA contracts is costly for both parties to the contract, and the existence of a SCP has the potential to allow some parties to realize efficiencies in the negotiation of such contracts. Furthermore, a SCP can encourage the formation of a liquid market for the exchange of RA obligations, which in turn leads to the efficient allocation of resources with the associated benefit of reducing costs to electricity consumers in California. For these reasons, Mirant supports the concept of a properly administered SCP.

However, in its current form, the SCP Straw Proposal furthers a regulatory compliance goal rather than a market facilitation goal. In Mirant's opinion, the two goals are not necessarily mutually exclusive, but in this case, the SCP Straw Proposal will be a detriment to the market. By proposing an overly prescriptive, mandatory SCP framework, the CAISO will impose greater, not lesser, transaction costs on the procurement of RA capacity, which in turn interferes with the efficient operation of the market.

Many of the difficulties with the SCP Straw Proposal could be solved with a shift back to market facilitation as the primary goal. In particular, the SCP should be viewed as an optional product for RA market participants. In no event should the SCP be used as the sole yardstick against which market participants would demonstrate compliance with their existing RA obligations. Instead, the SCP should become an additional option under which market participants can meet their future RA obligations. Adhering to the market facilitation approach by making the SCP optional rather than mandatory will mean that transitional/grandfathering issues disappear; existing RA contracts will continue in their existing form while newly negotiated contracts may incorporate the SCP standards. If parties to existing RA contracts wish to modify their RA contracts to conform to the SCP standards to take advantage of market opportunities, that decision would and should be left to the parties. Furthermore, an optional approach means that parties to existing RA contracts will not face the potential of duplicative penalties resulting from application of a SCP penalty that differs from a damages clause in an existing RA contract.

Availability

One issue that has not been discussed on previous conference calls, but to which some consideration must be given is the determination of different agencies to focus on different types of outages in their policymaking decisions. The present RA counting rules adopted by the California Public Utilities Commission (CPUC) were designed to take into account the fact that all units are subject to forced outages. Therefore, the RA requirement of the load serving entities includes a planning reserve margin of 15 to 17 percent of expected load to reflect the reality of forced outages. To ensure that enough capacity is available, however, the CPUC's current rules provide for reductions in countable net qualifying capacity (NQC) for planned outages. In effect, the CPUC penalizes generators for planned outages, or, stated another way, incents generators to minimize their planned outages.¹ In contrast, the proposed CAISO rules for the SCP focus on forced outages, creating an incentive to minimize the same outages that the CPUC has already built into its planning reserve margin. Therefore, the current CPUC counting rules, which focus on planned outages, and the proposed CAISO rules, which focus on forced outages, seem at best to create penalties for any form of outage and at worst create overlapping penalties. Further consideration must be given to the consequences of the interplay of two different policy determinations to ensure that they will not result in distortions in market behavior or conflicting penalties.

On the topic of forced outages, Mirant is concerned that the MRTU systems, as currently designed, do not differentiate between forced outages within the control of Mirant and forced outages beyond the control of Mirant. For example, Mirant does not believe that the SCP framework should treat outages due to environmental issues and other issues beyond the control of the generator, such as permit-driven operational limits, transmission/switchyard outages, or forbidden zones, the same as an outage due to a pump failure. Mirant is also uncertain whether such events can be adequately managed via SLIC due to MRTU software deficits. Further consideration of these issues is warranted before the SCP can be implemented.

¹ These rules have been incorporated into existing, standard RA contracts used by the Investor-Owned Utilities (IOUs) in their bi-lateral procurement process.

There was also a suggestion during a stakeholder conference call that "use limited resources" should enter outages once they reach a permit threshold. However, such constraints are an environmental issue that should not constitute a forced outage with the potential for penalties.²

When establishing availability standards, the CAISO should create separate categories of generators (e.g., thermal and intermittent) and apply distinct availability standards to each category. It is unreasonable to hold thermal and intermittent units to the same standards due to the difference in operational characteristics of those units. For example, intermittent resources presumably would not be penalized for lack of wind, sun, or water. That would result in situations where the intermittent resources may have little availability all year with no penalty, and the absence of a risk of penalty creates an unlevel playing field with other generators.

Regarding availability standards generally, when setting such standards, Mirant prefers that the CAISO employ a three-year average instead of the proposed one-year average. Further analysis must be made regarding standards that would apply to forms of new generation with inadequate historical data upon which to base a standard.

Penalties/Bonuses

Mirant's most significant concern in the area of penalties and bonuses is the impact a new SCP would have on existing RA contracts. In particular, the creation of an SCP should not expose existing providers of RA resources to the possibility of double penalties, once under the SCP and a second time under the damages provision of an RA contract. The most effective solution to alleviate this concern is to make the SCP optional and to leave in place without modification existing RA contracts. If the CAISO nonetheless mandates adherence to an SCP framework, then it should grandfather existing RA contracts and explicitly establish that parties to such contracts are not subject to SCP penalties.

In the event the CAISO adopts a mandatory SCP without grandfathering existing RA contracts, the CAISO should apply the SCP availability penalty to the RA buyer. Under this approach, if a seller is forced out, that seller would pay the RA contract penalty to the buyer per the terms of the RA Agreement, and the buyer would have to pay the CAISO for any SCP penalty. The penalty effectively becomes a pass-through from the seller to the CAISO, thereby ensuring that a generator does not face multiple penalties for a single event of non-compliance.

Despite the concern regarding a possible double penalty, Mirant does not oppose the creation of a bonus pool to provide an incentive for generator availability as contemplated in the SCP Straw Proposal. A bonus pool has the potential to increase average availability of units, in turn encouraging new generation to replace older, less reliable units. However, for an incentive

² Under existing CAISO standards, Mirant has received a determination that its units do not fall under the "use limited" definition, because the definition is based on a daily determination, and the Mirant units are subject to annual use limitations, a fact that cannot be flagged in the CAISO-maintained master file. Nonetheless, given existing CAISO systems, the "use-limited" nature of the Mirant units looks like a forced outage with the potential to trigger unjustified penalties. To remedy this issue, the CAISO must create SLIC outage codes that are specific to forced outages to accommodate software deficiencies that cannot differentiate among different forms of outages. Until this occurs, the SCP-related concept of a forced outage cannot be applied in a standard manner.

to work, the possible reward must be clearly defined and must not be contingent upon factors beyond the control of the generator. Unfortunately, the SCP Straw Proposal's bonus provisions suffer from these defects. The bonus pool would be funded from the penalties collected under the SCP availability standards. Under this arrangement, if a generator qualifies for a bonus in a period where there are no penalties collected, then that generator would get no bonus. Alternatively, if one generator qualifies for a bonus in a period of high penalties and there are no other bonus-eligible generators, then that lucky generator is eligible for a windfall. To fulfill its function, a bonus must provide a concrete, measurable incentive against which the economic merits of certain actions (e.g., ensuring availability) can be measured. Without such relative certainty, the bonus becomes little more than a jackpot for those generators fortunate enough to have exceeded availability limits during the right time and a hollow promise for those generators that exceed availability limits when the pool of funds is scarce. The SCP framework should offer a defined bonus that is not based solely on the penalty pool, but is supplemented, if necessary, to ensure predictable incentives.

Any penalty/bonus arrangement must also ensure that it does not provide compensation to those generators who do not deserve it. For example, when forced outages are the standard against which availability is measured, units with only a partial RA commitment would have a definite advantage over those units which are fully RA committed. In that scenario, a 100 MW unit with 25 MW RA capacity could be unavailable 75% of the time yet still qualify for bonus payments. The CAISO certainly should not reward such units that are unavailable this infrequently.

Finally, on the most recent stakeholder conference call, there was a suggestion that the CAISO should use excess penalty funds to pay for ICPM designations resulting from exceptional dispatch requirements. Mirant opposes this suggestion. The need for exceptional dispatch can be triggered by a variety of causes such as inaccurate forecasting or force majeure events. Mirant believes that issues generating exceptional dispatch requirements should remain separate from unit availability standards, and the suggestion to fund exceptional dispatch from SCP penalties blurs these lines.

Transition/Grandfathering

Negotiation of RA agreements is based on assumptions that influence the economic decision of whether to enter into the agreement. Changing the terms of the agreement is likely to undermine the benefit of the bargain negotiated by the parties. It is important, therefore, that the CAISO's policies not interfere with existing RA contracts. As discussed above, the most effective way to ensure this outcome is to make the SCP an optional product. The simplest way to do this may be to include a RA contract commencement date component in the SCP. Any SCP penalties/incentives that are implemented would only apply to resources whose RA contract commencement date occurred after the SCP implementation date.

To eliminate any ambiguity, the CAISO should grandfather existing RA contracts during the remaining life of such contracts, including any optional extensions contemplated under the provisions of those contracts. To implement this principle, the CAISO should continue to rely on grandfathered capacity in a CPUC-approved RA contract, in addition to any SCP tags that an

LSE may present, in satisfaction of RA compliance showings. Performance standards and damage provisions specified in grandfathered contracts would continue to apply in lieu of new standards adopted in the SCP. Mirant recognizes that this approach may impose additional compliance duties on the CAISO, but this is a necessary outcome to preserve the integrity of existing contractual obligations.

Timing

Mirant supports the creation of a SCP and is hopeful that a vibrant market for the trading of RA tags will arise. Such a market will help efficiently allocate energy resources and will ultimately benefit California's electricity customers. However, Mirant is concerned that the current SCP Straw Proposal is overly regulatory, raising the potential for significant unintended consequences. Based on these concerns, the CAISO should focus on resolving the issues related to the creation of the SCP even if it means that the SCP will not be available in time for 2010 RA compliance requirements.