Stakeholder Comments Template

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

Submitted by	Company	Date Submitted
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RRI Energy appreciates the opportunity to provide the following comments on the CAISO's Straw Proposal. We provide some high level comments, followed by a response to each of the questions posed in the comment template.

RRI fully supports the CAISO's plan to recognize that it has both the practical responsibility and the tested authority to establish an additional purpose for the CPM to include addressing specific reliability needs that are not addressed in the RA requirements. In so doing, the CAISO recognizes that it ultimately bears the risk of resource adequacy, regardless of what capacity value is attributed to intermittent resources, or whether forward contracted RA prices are sufficient to retain all existing resources required to reliably operate the CAISO Balancing Area.

RRI also supports the CAISO's proposed "Option A" under which the CAISO would compensate backstop capacity procured under the CPM at a price based on the Cost of New Entry. Such a mechanism is not a substitute for a transparent, multi-year forward, centrally cleared resource adequacy mechanism, which can both effectively assure long term resource adequacy and provide an integrated backstop procurement mechanism. However, "Option A" can fulfill a needed backstop role to assure that the CAISO has the resources it needs to reliably operate its balancing area, while encouraging sufficient forward contracting. The CAISO should adopt a mechanism that uses a periodically updated value of the cost of new entry for the ceiling, and some percentage of that value as the floor.

The CAISO has implicitly answered the question of whether the CPM is intended to incent new investment by concluding that the maximum commitment period is 12 months or less – which means that only uncontracted capacity from existing generation can be expected to be available to cure any deficiency. It is therefore essential that the CAISO avoid establishing a pricing framework for CPM that could act as an artificially low de facto cap on forward RA pricing.

CPM

1. The appropriate duration of the tariff provisions associated with the CPM: should they be permanent or terminate on a certain date or under certain conditions? If the CPM should terminate, please be specific about the date or conditions upon which it would terminate and indicate the reasons for your proposal.

The CAISO proposes a “durable backstop mechanism” but suggests that the compensation and pricing would be reviewed every two years, and the design elements would be reconsidered based on regulatory or market changes “should the need arise.”

Without a centralized capacity market, it’s difficult to design a true market mechanism as a backstop procurement tool, the CAISO should nonetheless seek to design an administrative mechanism that incorporates the current cost of new entry. Rather than setting out to redesign the mechanism every two years, the CAISO should target the specification of a durable framework for which a limited number of design details, such as the cost-of new entry, are periodically reviewed (e.g., every two years).

2. The appropriate treatment of resources that may be procured through CPM or Exceptional Dispatch but then go out on Planned Outage during the period for which the resource has been procured. What are your views on the proposed formula in the straw proposal for compensating such resources?

There are additional considerations that the CAISO should take into account before concluding that CPM payments should be pro-rated for Scheduled Outages.

First, Planned Outages must be approved by the CAISO. If the CAISO requires a resource for a period of time during which it is partially unavailable due to a Planned Outage, then the CAISO could consider that unavailability in its selection criteria, and procure another unit. Alternatively, under Section 9.3.7 of the CAISO Tariff, the CAISO Outage Coordination Office may at any time request a change to an approved outage if the change is “required to secure the efficient use and reliable operation of the CAISO Controlled Grid,” or may cancel a Planned Outage up until the day before it is scheduled if “necessary for to preserve or maintain System Reliability.”

An additional consideration is that, for dispatchable resources, Planned Outages do not reduce Qualifying Capacity, and Scheduled Outages are not included in determining availability hours for the purpose of the Standard Capacity Product Non-Availability Charge. Further, the 30 day procurement period is arbitrary, and if a full year commitment were made to a resource secured by CPM, then it would be altogether inappropriate to include an adjustment to pro-rate payments for Scheduled Outages, as generating units must perform annual scheduled maintenance sometime in the year if the CAISO is to reliably operate the grid.

3. Modification of the criteria for choosing a resource to procure under CPM (section 43.3) to provide the ISO with the ability to procure non-use limited capacity over use-limited capacity.

RRI believes that a preference for non-use-limited resources over use-limited resources is reasonable, if all other relevant criteria are comparable. As RRI has previously noted, however, giving preference to resources with a particular operating characteristic may involve significant trade-offs. For example, location, start time, ramp rate and inertia might vary significantly from among eligible resources that reasonably fulfill the primary procurement purpose – but the value of such features might differ significantly among those same resources depending on what operating conditions arise over the duration of the commitment period.

4. The three new types of procurement authority for generic backstop capacity the ISO is proposing.

The CAISO's proposed use of the CPM for each of these purposes is reasonable, and RRI supports including them in the CAISO's final proposal.

For scheduled transmission outages, using the backstop capacity procurement mechanism rather than Exceptional Dispatch is better aligned with the nature of the need, since local capacity requirements are temporarily increased. Procuring services from non-RA, non-RMR, non-CPM capacity using such mechanism is reasonable. The CAISO should consider, however, whether it is reasonable to only procure this capacity for 30 days. The annual going forward costs for any available resource are likely to substantially exceed even the highest possible value earned through a 30 day CPM commitment. The CAISO should consider whether a full year commitment should be made, and document it's rationale for any shorter period.

The second type of generic capacity that the CAISO proposes to procure using the CPM would replace RA capacity attributed to intermittent resources that under-perform relative to the capacity value they are assigned. The CAISO is ultimately responsible for the reliable operation of the CAISO balancing area, and just as ISO New England has the authority to adjust the applicable Installed Capacity Requirement, so too should the CAISO have the authority to procure through its backstop CPM that capacity necessary to make up for deficiencies it finds in the capacity available from intermittent resources. As California moves toward a 33% renewable portfolio standard, the CAISO must have the authority necessary to assure that it has sufficient capacity to meet its responsibility for reliable operation of the balancing area. It is unclear why the CAISO would propose that this procurement authority would be limited to 30 days, and the CAISO should consider establishing its authority to enter longer term arrangements for such capacity.

The third type of generic capacity the CAISO proposes to procure under the CPM is from resources that "are needed for reliability that are in danger of shutting down due to lack of sufficient revenues," and proposes that the CAISO be able to contract for up to

12 months for such capacity. The CAISO is faced with assuring availability of existing generation that is needed for reliable system and local operations without the best tool to provide that assurance – a systematic and transparent multi-year forward centralized capacity market. However, given the risks of early retirement of key units well ahead of OTC deadlines, combined with the enormous requirement for voltage support, inertia, ramping, balancing and Regulation services that the CAISO will require, the proposed use of CPM to retain existing capacity is reasonable – but the timing of decisions regarding mothballing or retirement may not be affected by a commitment that extends only 12 months.

5. The compensation that should be paid for generic capacity procured under CPM and Exceptional Dispatch. Which method do you support: Option A – CONE net of peak energy rent; or Option B – going forward costs? Are there further modifications needed to either of these pricing options? If you have a specific alternative pricing proposal, please provide it and indicate the reasons for your proposal.

RRI supports Option A as a starting point for designing an appropriate backstop mechanism. As the CAISO Straw Proposal notes, "the approach based on the cost of new entry is clearly more aligned with investment price signals." RRI supports an administratively determined demand curve with a cap based on the net cost of new entry, as proposed by the CAISO, and a floor based on some percentage of the cost of new entry.

RRI supports the CAISO's use of the average CEC value of $229/kW-year as a target capacity price, and does not object to the proposal that this value represent the target capacity price for all local areas.

Since no market valuation of peak energy rents is made under an administrative pricing approach, no true ex ante basis for making a peak energy rent adjustment is available. Therefore, RRI supports the CAISO's proposal to use the actual peak energy rent earnings for the procured resource in determining net CONE. Such a unit-specific approach assures that peak energy rent adjustment is not over-stated for resources with fewer starts and operating hours, and therefore smaller peak energy rents.

CAISO goals include ensuring that the CPM pricing supports efficient forward RA contracting, which Option A will facilitate by providing transparent prices that are referenced to the cost of new entry.

Price discrimination between existing and new capacity is unsustainable as recognized in the CPUC ALJ's initial draft decision on capacity markets in R.05-12-013. After careful consideration of the voluminous record in that proceeding, the ALJ concluded that price discrimination would be at odds with the CPUC's primary objective to achieve investment needed for reliability, would be inconsistent with a commitment to greater price transparency and symmetry of information available to market participants, and that any "savings to ratepayers that result from paying less than new entry cost to existing resources may be short-term and come at a long-term cost."[1] In summary, defining backstop procurement pricing based on the cost of new entry is in the best interest of California's electric customers.

The CAISO has already made a critically important concession in which it defers to the CPUC and the RA program by concluding that the CAISO will not provide multi-year contracts for backstop capacity, which also means that the CAISO will not be pursuing a multi-year forward backstop capacity market. Such a mechanism would substantially influence the CPUC's existing year-ahead, bilateral RA structure, and while clearly within the CAISO's authority to establish, RRI Energy does not dispute that such a mechanism would be difficult to implement and is a poor substitute for a long term RA framework built on the foundation of a centrally cleared, multi-year forward capacity market.

In considering the interaction between the CPM pricing mechanism and the CPUC penalties and waiver terms, the CAISO suggests that "sellers could, in some circumstances, use the backstop price to negotiate a higher forward RA price, particularly in locations where capacity is tight." Two additional points need to be considered. First, the adequacy of the existing prices cannot be assessed based on the infrequent use of the CPUC penalties and waiver, since the existence of the waiver value of $40/kW certainly influences forward contracting by giving LSEs a safe harbor and no incentive to pay more than the waiver price, regardless of the value of capacity. Second, it would be erroneous to conclude that suppliers will be able and willing to demand high RA prices by threatening to forego such contracts in anticipation of backstop capacity procurement. Such a strategy carries significant risk, and many if not most suppliers would prefer to book the forward RA sale at a meaningful discount rather than gamble on an uncertain backstop procurement contract.

6. The need for the ISO to procure non-generic capacity under CPM and Exceptional Dispatch to meet operational needs.

The CAISO's first priority should be to assure that the reliability products that are necessary to meet all applicable reliability criteria are defined and transparently procured using competitive markets. An integral step towards this is ensuring that the ISO includes accurate constraints in its market software to reflect applicable reliability criteria. Any procurement of "non-generic" capacity based on its capability to deliver such services should only be used as a last resort, and only with complete transparency regarding the requirements leading to such procurement. In the interest of assuring a coherent strategy for securing capacity that meets the CAISO's operational needs, the CAISO should consider deferring consideration of procurement of non-generic capacity until after the CAISO conducts its review of new products required for renewable integration.

[1] See Proposed Decision of ALJ Wetzell, "Decision on Phase 2 – Track 2 Issues: Adoption of a Preferred Policy for Resource Adequacy", November 3, 2009, in R.05-12-013, pages 37-38. Available on line at: http://docs.cpuc.ca.gov/efile/PD/109412.pdf

7. The operational criteria the ISO is proposing to distinguish certain operational characteristics as non-generic capacity (fast ramping and load following). Are these two characteristics enough, or do you propose additional criteria for operating characteristics that would qualify for non-generic capacity?

The CAISO should complete its review of what services are required and how they might be procured through existing and new ancillary service markets before specifying the characteristics of non-generic backstop capacity.

8. How should non-generic capacity be compensated? What are your views on the proposal to compensate non-generic capacity by applying an adder to the price paid for generic capacity?

See response to questions 6 and 7.

<u>Exceptional Dispatch</u>

1. Should energy bids for resources dispatched under Exceptional Dispatch continue to be mitigated under certain circumstances? Should such mitigation continue the current practices of bid mitigation as outlined in the straw proposal?

Energy delivered in response to Exceptional Dispatch should be paid as-bid unless a supplier is demonstrated to have unilateral market power. Under Section 39.10 of the CAISO Tariff, all Exceptional Dispatches that are for the purpose of addressing reliability requirements related to non-competitive transmission constraints are mitigated. In approving the MRTU competitive path assessment, FERC agreed with market participants that the three-pivotal supplier index used in the competitive path assessment might be overly stringent. Given that the frequency and conditions under which the CAISO deems a path non-competitive directly influences mitigation of bids by units that are Exceptionally Dispatched, the CAISO's competitive path assessment process is necessarily within the scope of the review of Exceptional Dispatch compensation.

Therefore, the CAISO must follow-up on the May 28, 2010 report on LMPM performance by the MSC, identify any empirical evidence of the exercise of market power, complete any required analysis of alternatives such as a residual demand curve, and expedite revisions to the LMPM to use better information to eliminate unnecessary mitigation when the successor rules for bid mitigation under Exceptional Dispatch become effective on April 1, 2011.

2. Should the ISO change the categories of bids subject to mitigation under Exceptional Dispatch (Targeted, Limited and FERC Approved) and extend the bid mitigation for the existing categories?

The CAISO should continue its efforts to minimize the volume of energy and capacity procured by Exceptional Dispatch. Bid mitigation should only occur when there is a demonstrated unilateral ability to exercise market power. The current use of Exceptional Dispatch can have the effect of muting economically justified price signals in the CAISO's markets. Default mitigation would further obscure price signals essential to making good investment decisions in electric infrastructure, including the locational price difference necessary to guide investment.

3. What is the appropriate compensation for non-RA, non-RMR and non-CPM capacity that is Exceptionally Dispatched? Should the current compensation methodology be extended, updated to agree with what is put in place for CPM for generic capacity procurement?

Capacity that is not under an existing capacity contract should receive an award under the CPM mechanism.

Other

1. Do you have any additional comments that you would like to provide?

RRI appreciates the opportunity to provide comments, and commends the CAISO on the thorough discussion of the issues provided in the Straw Proposal.