

Memorandum

To: ISO Board of Governors
From: Charles A. King, P.E., Vice President, Market Development & Program Management
Phil Pettingill, Manager, Infrastructure Policy & Contracts
Date: January 18, 2008
Re: *Decision on Interim Capacity Procurement Mechanism Tariff Filing*

This memorandum requires Board action.

EXECUTIVE SUMMARY

Over the past nine months, California ISO staff has collaborated with stakeholders to develop an interim, tariff-based, capacity procurement mechanism to be implemented coincident with start-up of the Market Redesign and Technology Update (“MRTU”). The purpose of this capacity procurement mechanism is to enable the CAISO to supplement or “backstop” Load Serving Entity (“LSE”)-based Resource Adequacy (“RA”) capacity procurement as needed for reliable grid operations. For example, if a LSE did not procure sufficient capacity to meet its full RA requirement, and it did not cure the deficiency when given an opportunity to do so, then the CAISO would procure the needed capacity to fulfill the RA requirement.

The goal is to file this new Interim Capacity Procurement Mechanism (“ICPM”)¹ with the Federal Energy Regulatory Commission (“FERC”) on January 30, 2008 and propose an effective date coincident with the start of the MRTU markets. As the culmination of a lengthy and rigorous stakeholder process, the ICPM proposal effectively meets the CAISO’s objectives for an interim backstop mechanism, is compatible with both the MRTU market design and, in the interim, the State of California’s existing RA program as well as efforts to design a long-term RA framework, and attempts to strike a reasonable balance between the divergent views of stakeholders.

Throughout the stakeholder process, parties expressed widely different points of view on many of the elements of an ICPM. This proposal reflects numerous modifications to prior staff proposals in order to address concerns expressed by stakeholders. Even with these changes, this proposal is not without controversy, and there is not unanimous stakeholder support for each and every element of the proposal. However, Management believes that this ICPM proposal constitutes a reasonable,

¹ This mechanism is an “interim” mechanism because it will include a sunset date at the end of 2010. Prior to that date, the CAISO will explore with stakeholders the development of a backstop procurement mechanism that will effectively complement the long-term RA framework that is currently being developed in an ongoing proceeding before the California Public Utilities Commission (“CPUC”).

balanced and interim approach that takes into account the widely divergent views expressed by stakeholders and the fact that important long-term RA issues remain unresolved.

The ICPM will allow the CAISO to backstop or supplement the RA procurement of LSEs to ensure that there is sufficient generation capacity available to the CAISO operators to maintain reliable grid operations. The CPUC and local regulatory authorities establish the RA requirements, and RA generation is then made available to the CAISO through required offers into the MRTU daily markets for energy and ancillary services.

The key elements of the ICPM are as follows:

- The tariff provisions automatically sunset on December 31, 2010. The intent is to revisit and refine the backstop mechanism after further progress is made at the State of California level regarding the design of a long-term RA framework. The CAISO's intent is to develop a more permanent backstop mechanism in the future that will complement the long-term RA design.
- There are two circumstances that would trigger procurement under the ICPM. The first type of procurement would backstop the RA process and occur if an LSE or group of LSEs has not purchased the full amount of their local or system-wide RA requirements by the time of the required RA showing for that year,, or, even if they had met the required procurement targets, sufficient capacity was not procured to meet specific CAISO locational needs. This type of backstop procurement would occur in advance of the applicable compliance period. The second type of procurement would occur if the CAISO determines that a "Significant Event" has occurred that creates a need to supplement LSE-procured capacity within the compliance year in order to maintain reliable grid operations.
- Significant Events are defined as "a substantial event, or a combination of events, that is determined by the CAISO to either result in a material difference from what was assumed in the resource adequacy program for purposes of determining the Resource Adequacy Capacity requirements, or produce a material change in system conditions or in CAISO-Controlled Grid Operations, that causes, or threatens to cause, a failure to meet Applicable Reliability Criteria absent the recurring use of a non-Resource Adequacy Resource(s) on a prospective basis". As it is impossible to foresee all potential events that could occur during the operating year that would jeopardize the CAISO's ability to meet the reliability criteria that it must satisfy as a system operator, the definition by necessity accords some discretion to the CAISO. Thus, the need for the reporting requirements described below.
- The term of payments to an ICPM resource varies from one month to up to 12 months depending on the RA requirement deficiency being remedied or the length of the Significant Event.
- The price paid to a resource for its capacity is based on the going-forward costs of a new conventional simple-cycle unit, as reflected in a draft June 2007 California Energy Commission ("CEC") report,² plus a 10% adder from that number.³ Going-forward costs

² June 2007 California Energy Commission Draft Staff Report, Comparative Costs of California Central Station Electricity Generation Technologies

³ Going-forward costs are defined here as the sum of fixed operations and maintenance costs, ad valorem costs, and administrative and general costs. A 10% adder is in-line with previously approved adders and, among other things, will encourage LSEs to not simply rely on the ICPM backstop mechanism to meet their RA requirements.

are the core fixed costs that a generation unit needs to make itself available for operation for the term of designation, but do not include such elements as return on investment.⁴ The ICPM offers a Target Annual Capacity Price of \$41/kW-year, but with no deductions for peak energy revenues (or ancillary service revenues). Payment would be subject to an availability factor and a level monthly shaping factor. The target price is known to be higher than the going-forward costs of many existing units (hence, for those units the payment provides additional revenues). A resource owner that believes that its going-forward costs are greater than \$41/kW-year would be able to file at FERC for a price higher than \$41/kW-year, but the owner would have to justify that price to FERC based on the same cost elements that are considered in setting the \$41/kW-year default price. This pricing rule is intended to cover certain costs while allowing the resource to retain energy and ancillary service revenues as a means to cover other costs and provide profits; however, it is not intended to be a cost recovery guarantee mechanism such as a Reliability Must Run Agreement.

- Participation in the ICPM by a resource is voluntary. A resource owner does not have to accept an ICPM designation when offered by the CAISO. The CAISO considered a mandatory designation scheme, but has determined that there are adequate incentives within the proposal for resources to be willing to accept the designation, including the provision where an owner of a resource can request a payment higher than \$41/kW-year if justified to FERC on a cost-basis. Further, FERC has ruled that there is no "Must-Offer Obligation" under MRTU. The CAISO also believes that a voluntary approach is appropriate given that there is no consensus among stakeholders – indeed the parties are extremely polarized on the issue of the appropriate price to be paid to resources designated under the ICPM.
- The CAISO would have the ability to procure a portion of a resource rather than its entire capacity. Criteria are provided for determining which resource would be selected for an offer of an ICPM designation when there are multiple resources that could fulfill the need for the capacity. The CAISO has the expectation that such criteria will always lead to a set of specific resources that are uniquely qualified. However, in the event there is a "tie" among resources, the CAISO would use a random selection mechanism.
- Extensive reporting requirements are included to ensure that all ICPM procurement is transparent to the market and an information feedback loop is provided to the CPUC and local regulatory authorities so that those entities can improve their RA programs over time.
- Ultimately, the pricing and procurement rules for a successor to ICPM need to be integrated with the State of California RA program. The question of backstop capacity procurement is a component of the CPUC long-term RA proceeding and CAISO has provided its preliminary views on backstop procurement in that proceeding.⁵ Alternative future designs for such procurement may emerge from that proceeding.

The full proposal is provided in Attachment A.

⁴ This is a different pricing basis than the prior Reliability Capacity Services Tariff price formula, which offered a higher Target Annual Capacity Price, based on a settlement price, but then deducted peak energy revenues.

⁵ California ISO, Assessment of Centralized Capacity Market Proposals, September 14, 2007.

The Market Surveillance Committee (“MSC”) has issued an Opinion on the ICPM, which is provided in Attachment B.

MOTION

Moved, that the ISO Board of Governors approve the Interim Capacity Procurement Mechanism as outlined in the memorandum dated January 18, 2008, and related attachments; and

That the ISO Board of Governors authorizes Management to make all the necessary and appropriate filings with the Federal Energy Regulatory Commission to implement this proposal.

BACKGROUND

The CAISO’s Reliability Capacity Services Tariff (“RCST”), which came about as a result of an Offer of Settlement filed at FERC on March 31, 2006 and approved by FERC on February 13, 2007 allows the CAISO to procure capacity in advance of the compliance year to backstop RA procurement and during the compliance year to backstop for a Significant Event. The RCST was initially intended to provide a daily capacity payment for units subject to a must-offer waiver denial, which meant that they were required to offer into the CAISO market. The State of California established its annual RA requirements roughly contemporaneously with the RCST implementation, but local RA requirements were never factored into RCST pricing. Subsequently, the ICPM discussions became a forum for airing RA issues and for exploring RA-type pricing options for backstop procurement on both the local and system levels. However, as discussed below, given the difficulties in resolving those issues at this time, CAISO has decided to continue with an interim pricing approach similar to RCST.

Under the ICPM, the CAISO proposes to follow a RCST-type framework with certain modifications to make it compatible with the MRTU market design and facilitate the CAISO’s ability to meet Applicable Reliability Criteria,⁶ as well as other enhancements. In general terms, an “RCST-type framework” means that the CAISO is able to procure capacity to backstop either RA requirements or address a Significant Event, and pay resources a tariff-based price for the service provided for a term of varying length depending on the need..

The CAISO believes that it makes sense to retain some of the RCST design elements and make modifications to others in order to adapt it to function effectively under MRTU. This is because stakeholders invested substantial resources in developing the RCST, FERC has found it to be just and reasonable, and many stakeholders have stated a desire to use it as a general framework for developing an interim MRTU backstop mechanism.

This proposal is consistent with RCST in that it provides for the same two primary types of backstop procurement. Under “Type 1” procurement, the CAISO would procure capacity (a) in advance of the compliance year if an LSE has not procured the full amount of its RA requirement by the time of the required RA showing, or if the portfolio of resources procured by all LSEs in a local area is not

⁶ As part of Applicable Reliability Criteria, the CAISO must comply with applicable North American Electric Reliability Council/Western Electricity Coordinating Council requirements, including Minimum Operating Reliability Criteria.

sufficient to fully meet the operating needs of the local area, or (b) during the compliance year if an LSE has not procured the full amount of its RA requirement in the month-ahead time frame. Under "Type 2" procurement, the CAISO would procure additional capacity during the compliance year if a "Significant Event" occurs that creates a need to supplement LSE-procured RA capacity to ensure reliable grid operations. For example, a Significant Event could be a sustained outage of a generation or transmission facility.

POSITIONS OF THE PARTIES

A matrix summarizing stakeholder views on the key elements of this proposal is included in Attachment C. General comments related to the design of the ICPM are discussed below.

Effective Date – The CAISO proposes to implement the ICPM on the effective date of MRTU implementation. Some stakeholders have argued that ICPM should be implemented prior to MRTU, upon the expiration of the RCST. On December 20, 2007, in response to a motion filed by the Independent Energy Producers Association ("IEP") requesting that FERC require the CAISO to file the ICPM proposal to be effective January 1, 2008, FERC ordered that the ICPM need not be filed and made effective on January 1, 2008, and instead preliminarily concluded that the RCST should be extended until the start of MRTU or an alternative backstop mechanism is filed. FERC has initiated a Section 206 proceeding to address the limited issue of whether the RCST should be extended until the earlier of MRTU implementation or implementation of an alternate backstop capacity mechanism. Comments regarding the justness and reasonableness of extending the RCST were filed on January 9, 2008, and reply comments are due on January 24, 2007. FERC has indicated that should be able to render a decision on this issue by March 30, 2008.

Need for ICPM –The CAISO believes that a backstop mechanism is an appropriate and necessary feature to complement the MRTU market design, and many stakeholders generally support the concept of the CAISO having a backstop capacity procurement mechanism. However, in many cases, that support is conditioned on certain features that the party would like to see (or not see) included in the ICPM. There are stakeholders that do not support Type 1 procurement, some that do not support Type 2 procurement, and some that do not support either type of procurement. The CAISO has worked with stakeholders over the last nine months to attempt to resolve these issues, and in response to their concerns has added many features to the ICPM to provide for increased transparency and appropriate checks and balances to protect against unnecessary over-procurement. Management feels strongly that both Type 1 and Type 2 procurement are necessary mechanisms to include in the MRTU market design in order to enable the CAISO to maintain reliable grid operations.

Duration of Tariff Provisions – The CPUC has an ongoing proceeding to develop a long-term design for RA. This design may include a capacity market - and a backstop mechanism may be part of that structure. Numerous stakeholders have requested that the design of ICPM not get out ahead of efforts to develop the long-term RA framework. In response to this request, the CAISO has proposed that the ICPM tariff provisions will automatically sunset on December 31, 2010. The ultimate goal is to design a long-term backstop mechanism under MRTU that works effectively under, and is aligned with and complementary to, the long-term RA design. It may be appropriate to revisit the ICPM sooner than the year 2010, depending on the timing of implementation of the long-term RA mechanism and types of mechanisms being implemented as part of that design. CAISO

staff expects to return to the Board at some point in the future with a proposal for a more permanent backstop mechanism than ICPM.

Compensation Paid to Resources for Capacity – Pricing has been one of the more complicated and controversial issues with backstop procurement. The current RCST Target Annual Capacity Price is \$73/kW-year, subject to *ex-post* deductions for peak energy rent revenues and other adjustments. While this was a negotiated value for both Type 1 and Type 2 procurement that was included in an Offer of Settlement, FERC has approved it as a just and reasonable rate as part of the current Must-Offer Obligation.

In initial discussions with stakeholders for a successor to the RCST, stakeholders were split, with one group favoring extending the RCST with most of its provisions intact, updating as needed to function under MRTU, and another group, that included most merchant generators, that desired a very different successor, with a much higher Target Annual Capacity Price and more liberal criteria for designating units (for example, calling on a resource one time during the year would automatically result in a designation for many months – perhaps as long as 12 months – at a price as high as about \$160/kW-year).

The initial pricing proposal presented to stakeholders by the CAISO used the RCST \$73/kW-year price, updated it to a 2008 value of \$74.83/kW-year, and then stair-stepped it up to a price of \$95.09/kW-year for the year 2012 (all of these prices would have been subject to the peak energy rent revenue deductions). This pricing structure was a compromise approach for a transitional phase-in toward the cost of new entry. There was some support for this proposal, but many stakeholders did not support it, for varying reasons. Some stakeholders said that it was not appropriate to pay the cost of new entry or even close to that value for this product (arguing that the existing RCST price was already too high), and recommended prices based on the actual cost of the existing fleet of resources (which would have been considerably less than \$73/kW-year). Conversely, merchant suppliers said that the pricing structure was too low and the price should be at the cost of new entry, which would be in the range of \$150-\$200/kW-year. Given this wide disparity in positions, the CAISO determined that it needed to try to develop a pricing structure that could bridge these points of view.

During the ensuing weeks after the initial proposal was presented, the CAISO explored pricing options suggested by stakeholders. Many stakeholders thought that the prices included in previous ICPM proposals were either too high or too low. Merchant suppliers generally supported higher prices (many supported a price based on the cost of new entry – and some supported that price for all backstop procurement), whereas LSEs, the CPUC and the California Electricity Oversight Board generally supported lower prices (many supporting either cost-based prices similar to the structure of Reliability Must Run Agreements, or a going-forward fixed cost methodology on a per unit basis). None of these options distinguished Type 1 and Type 2 procurement. However, the CAISO identified deficiencies with each of these options that made them unworkable without modification. Essentially, the CAISO basically agreed with merchant suppliers that locations where capacity was tight potentially justified a Type 1 backstop price based on cost of new entry, which is intended to signal a need for investment. However, locations where capacity was in substantial surplus did not seem to justify a Type 1 price that high. Rather, the pricing needed to reflect the surplus by providing for locational prices that were proportionately less than the cost of new entry. The CAISO also agreed in principle that Type 2 pricing did not need to reflect RA market fundamentals. In that

instance, the CAISO was procuring a temporary product for operational purposes and a cost-based price to cover “going forward” costs seemed sufficient.

Hence, the CAISO attempted to find a middle ground based on RA market design principles by using a market-proxy price derived from an administrative capacity demand curve and price floor for Type 1 procurement and a uniform price based on “going forward” costs for Type 2 procurement. The Type 1 demand curve was capped at an estimate of the cost of new entry in areas at or slightly below their RA requirements. Under this approach, the cost of new entry price signal only applied initially to four local areas (out of 10 local areas). Although that proposal had support from some stakeholders, other stakeholders opposed the concept based, *inter alia*, on concerns that the implementation of such Type 1 pricing would interfere with market design issues being addressed in the ongoing CPUC long-term RA proceeding (which is considering, among other things, similar pricing mechanisms) and would adversely impact forward RA prices in the interim.

Having reviewed with stakeholders this large number of pricing alternatives, the CAISO believes that the current ICPM pricing proposal is preferable in the interim to the other options that were considered. Given the concerns raised during the stakeholder process, in particular the concern that the CAISO not get ahead of development of the long-term RA design with this interim mechanism, Management proposes that a uniform target annual capacity price of \$41/kW-year be paid for all capacity procured under the ICPM regardless of the type of procurement. Further, suppliers will be permitted to retain all market revenues. This price is based on four criteria: (1) it is based on the results of a June 2007 CEC study that identifies the going-forward costs of new generation in California; (2) it is consistent with FERC’s rationale in the order approving the RCST Settlement in that it does not create incentives for buyers or sellers to shift procurement to the ICPM; (3) it provides a uniform price sufficiently high to cover the “going-forward” costs of most generators that might be designated under ICPM (thereby reducing the need for individual generator cost justification filings); and (4) it will not change the incentives of CPUC-jurisdictional LSEs to procure RA prior to ICPM given the existing CPUC penalties and the \$40/kw-year trigger used by the CPUC to consider LSE requests for waivers from procuring capacity to meet RA requirements.

To meet these considerations, the \$41/kW-year price is based on recent cost estimates of the going-forward costs of gas-fired single and combined-cycle generating units. As noted, unlike the RCST pricing approach, there would be no deductions for peak energy rents. Payment would be adjusted by an availability factor that is currently in the RCST and a level (1/12) monthly shaping factor (i.e., the Target Annual Capacity Price of \$41/kW-year would be divided by 12 to determine the target monthly capacity price). Based on peak energy rent calculations under RCST, the CAISO estimates that this proposed pricing method will potentially increase revenues to units designated relative to the RCST price in the summer peak months. In addition, a resource owner that believes that its “going forward” costs are greater than \$41/kW-year would be able to file at FERC for a price higher than \$41, but the owner would have to justify that price to FERC based on the same types of costs that produced the \$41/kW-year default price.

The pricing reflected in this interim proposal recognizes that long-term RA design issues are still being discussed, which makes it difficult to design a more permanent market-based pricing rule at this time. The CAISO will initiate discussions with stakeholders regarding a permanent market-based pricing mechanism for backstop procurement in connection with implementation of a long-term RA design and seek to ensure that both structures are complementary.

Designation Process – The CAISO has developed a detailed process that sets forth the determination of the need for ICPM procurement, triggering events and interaction with stakeholders. The designation process for backstop procurement to remedy deficiencies in RA procurement is fairly straightforward (either the RA requirement has been met or it has not). Many stakeholders support this Type 1 procurement, although some stakeholders question the need for this type of procurement given the compliance measures in place at the CPUC such as a penalty for non-compliance. The CAISO believes that it is prudent to provide Type 1 procurement authority to the CAISO as “a last resort” in the event that the RA requirement is not met. The imposition of a penalty on an LSE does not guarantee that capacity will be there if the CAISO needs it.

Stakeholders generally expressed greater concern with Type 2 procurement for a Significant Event than with Type 1 RA backstop procurement. Some stakeholders support the Type 2 procurement. However, other stakeholders question the need for Type 2 procurement given the level of the RA requirements established by the CPUC and local regulatory authorities (they think the RA requirements level should be sufficient for the CAISO to reliably operate the grid). Virtually all stakeholders have requested that the CAISO clearly specify the circumstances that would give rise to a Significant Event and justify the CAISO's procurement of capacity. Many stakeholders feel that the mechanism for Significant Events should to be more prescriptive and/or specific than what is already included in the RCST.

Management believes that adequate flexibility is necessary to avoid the unintended consequences of an overly prescriptive approach. In that regard, Management believes that the Significant Event provisions of the RCST are overly prescriptive, and more flexibility is needed. In particular, sufficient flexibility is needed so that the CAISO can address unforeseen or changed circumstances or inherent inefficiencies or deficiencies in RA programs where lack of action by the CAISO to address a known problem could place the CAISO in the position, in the Day-Ahead timeframe, of facing the possible interruption of firm load or failure to meet Applicable Reliability Criteria. A reasonably flexible definition of a Significant Event is necessary to allow the CAISO to address contingencies and unexpected system conditions, and ensure its ability to satisfy reliability requirements. The CAISO does not support a prescriptive “hard trigger” for a Significant Event because it would not allow the CAISO to exercise prudent judgment and not make designations when they are not required. Adoption of a “hard trigger” could require the CAISO to make designations on a prospective basis even though the event that led to use of the unit has ended.

Designation is Voluntary – The proposal provides that a resource does not have to accept an offer of an ICPM designation from the CAISO. The intent is to keep the MRTU markets voluntary and motivated by market incentives as much as possible. However, many stakeholders and the MSC believe that a resource should be required to accept an ICPM offer from the CAISO. They believe that the CAISO has developed this mechanism to ensure that the CAISO can procure capacity when needed, and that the CAISO should be able to compel resources to accept the offer so that the CAISO's needs can be assured to be met and with minimal “shopping.” It makes sense to them to make it mandatory. Many stakeholders also are concerned that if the ICPM is voluntary some resources may decline the offer of ICPM designation, and hence the requirement to offer into the Integrated Forward Market (“IFM”), which could make it difficult to procure the necessary capacity and adversely affect reliability.

The CAISO believes that it is appropriate to make the ICPM designation voluntary because FERC has ruled there is no type of Must-Offer Obligation that non-RA/Reliability Must Run resources would be subject to under MRTU, and a mandatory designation requirement would be like a Must-Offer Obligation

that FERC has ruled will go away at the implementation of MRTU. The CAISO believes that a voluntary approach is appropriate given that there is no consensus among stakeholders – indeed the parties are extremely polarized on the issue of the appropriate price to be paid to resources designated under the ICPM. In addition, the ICPM pricing provides sufficient incentives for resources to accept a designation – it at least covers their going-forward costs and also allows resources to retain all revenues from the MRTU markets. The CAISO has not seen any compelling evidence to suggest that suppliers would have a clear reason not to accept ICPM designation due to expectations of greater compensation in the MRTU markets as non-ICPM resources. Moreover, even if that were the case, resources that had opted not to become ICPM resources would not be withholding their capacity from the MRTU markets, but rather continuing to offer it. Hence, the CAISO would have the resources available that it needs and reliability would not be affected.

As an additional safeguard, the CAISO Department of Market Monitoring will be monitoring whether resources have rejected designations and not participating in the market, to see if there is any physical withholding. Finally, the CAISO has additional tools under the MRTU tariff to operate the system reliably if resources, for whatever reason, decline an ICPM designation (i.e. Exceptional Dispatch⁷ and emergency declarations).

Interrelationship with Exceptional Dispatch – As noted above, the CAISO intends to keep the MRTU markets voluntary and motivated by market incentives as much as possible. Therefore, under the MRTU market design, the only remaining mandatory requirement to operate without a CAISO declared emergency is the Exceptional Dispatch. Such an operational need may arise for various reasons; however, an Exceptional Dispatch explicitly occurs outside the markets and therefore can only occur under certain conditions as specified in the MRTU tariff. Some stakeholders have argued that a resource owner may decline the ICPM designation because the owner of the resource may perceive that it can receive higher compensation as a non-ICPM resource through the MRTU tariff provisions regarding Exceptional Dispatch. The CAISO believes that these concerns are misplaced because further review suggests that Exceptional Dispatch compensation to a resource will be the same regardless of whether a resource accepts an ICPM designation.⁸

⁷ Under MRTU, Exceptional Dispatches are similar to the current out-of-sequence and out-of-market actions that may be taken by CAISO operators to address a system or local reliability issue that cannot be resolved through the CAISO market software or dispatches to Reliability Must Run resources. There are two major potential reasons why Exceptional Dispatches may be needed for local reliability issues: forced transmission or generation outages, and local reliability constraints not modeled in market software. In such cases, the CAISO has authority to manually dispatch specific generation units to address reliability issues. Units receiving Exceptional Dispatches for energy will be paid the higher of their bid price or the Locational Marginal Price. The CAISO expects that the frequency and duration of Exceptional Dispatches will be extremely limited.

⁸ If there is a major change to the system due to a transmission or generation outage, it will necessitate a modification of the IFM full network model. Hence, Exceptional Dispatch in any sustained fashion is likely not to affect the IFM market clearing but rather to take place after the IFM and Residual Unit Commitment markets have cleared, meaning that both RA and ICPM resources could still be subject to Exceptional Dispatch if they had offered into those markets and not been scheduled. The only pricing issue is that of what they are eligible to be paid under Exceptional Dispatch, which is the subject of a separate CAISO stakeholder process. The ICPM payment would be made regardless of the Exceptional Dispatch payment because the payments for Exceptional Dispatch are for the energy provided versus the capacity compensation of the ICPM payment.

Reporting – Stakeholders have requested that robust reporting obligations be established to ensure that all ICPM procurement is transparent to the market and that a “feedback loop” is established to provide information to stakeholders and regulators on how well RA resources, by themselves, are meeting the various operational needs of the CAISO. It is expected that this feedback loop would, over time, lead to improvements in the RA programs and result in less reliance on ICPM procurement. The ICPM proposal includes several different types of reports, including a detailed report that would be posted within 30 days after the CAISO has procured a resource through the ICPM, a market notice that would be issued within two business days of any ICPM procurement, a monthly report that would be posted within 10 calendar days after the end of each month that would show the non-market commitments of non-RA capacity, and ICPM information that would be included in the Operations report that currently is provided to the CAISO Board of Governors at each Board meeting. The reporting obligations in this proposal are consistent with the extensive reporting that stakeholders have requested.

ICPM Procurement in RA Showings – The CAISO proposes to provide information to the CPUC and local regulatory authorities on all ICPM procurement so that capacity procured under the ICPM can be considered by the CPUC and local regulatory authorities and potentially allowed to count towards satisfying an LSE’s RA requirement.⁹ Stakeholders have requested, and the CAISO supports, allowing all “Type 1” ICPM capacity procurement (procurement to backstop the RA process) to be included in RA showings so that LSEs receive credit for ICPM capacity for which they have paid. However, some stakeholders have requested that all ICPM procurement be allowed to be included in RA showings. The CAISO does not support allowing “Type 2” procurement (procurement to backstop for a Significant Event) to be included in RA showings and will reflect this position to the CPUC and local regulatory authorities. The CAISO is differentiating between Type 1 and Type 2 procurement on this issue because the reason for Type 2 ICPM procurement is that the RA resources already procured by LSEs are determined by the CAISO to be insufficient to meet Applicable Reliability Criteria. Thus, allowing LSEs to include Type 2 capacity in subsequent RA showings would result in a decrease of the available RA capacity, which would only exacerbate the conditions that lead to the Significant Event and potentially cause additional ICPM procurement.

MANAGEMENT RECOMMENDATION

Management recommends that the Board of Governors approve the policy elements underlying the proposed ICPM as described in this memorandum and attachments, and authorize Management to file the conforming tariff provisions necessary to implement the new mechanism.

Attachments

- Attachment A: Proposal to Board of Governors for ICPM Tariff Filing
- Attachment B: MSC Final Opinion on ICPM under MRTU
- Attachment C: Stakeholder Process for ICPM Tariff Filing

⁹ The CPUC and local regulatory authorities determine the rules under which capacity is allowed to “count” towards an entity’s RA requirement. Capacity that is determined to count towards a RA requirement is then included in a RA showing by the LSE. The CAISO does not determine the counting/crediting rules for capacity used by LSEs to fulfill a RA requirement.