

**COMMENTS OF THE ALLIANCE FOR RETAIL ENERGY MARKETS ON THE
CAISO's STRAW PROPOSAL REGARDING A STANDARD RA CAPACITY
PRODUCT**

November 21, 2008

The Alliance for Retail Energy Markets (AReM)¹ appreciates the opportunity to provide comments on the CAISO's straw proposal for facilitating the market development of a Standard Resource Adequacy (RA) Capacity Product (SCP). The proposal was issued November 11, 2008 and discussed at the November 18th stakeholder meeting. The discussions at the stakeholder meeting, while not resolving all issues, were helpful to AReM to crystallize the trade-offs inherent in certain design choices associated with the SCP. As result, AReM offers the following comments:

1. Schedule

AReM's highest priority for the SCP process is to achieve a February 2009 FERC filing, which would allow time for the market to develop and implement the SCP and associated confirms for 2009 monthly and 2010 annual RA compliance. AReM firmly believes that a filing date later than February 2009 jeopardizes market development of the SCP in time for 2010 RA compliance. Therefore, AReM strongly supports the CAISO's current schedule.

2. Effective Date of SCP Tags

The development of the SCP has been long delayed. Electric Service Providers (ESPs) and other market participants have been significantly hampered in their efforts to contract for RA by the lack of a standard, tradable product. These transactional complexities in turn have created complexities in achieving RA compliance, especially considering the month-to-month changes in load migration that require monthly sales or purchases of System RA. The RA compliance requirement was implemented for the CPUC-jurisdictional load-serving entities (LSEs) in 2006, meaning that, as of today, four annual compliance filings have been made without the benefit of a standardized product. Accordingly, AReM is seeking immediate effectiveness of the SCP Tag, once approved by FERC. Assuming a February filing date, the FERC decision would be expected by April 2009 and the market could be expected to develop a standardized confirm within one to two months. Therefore, AReM's members would plan to use the SCP Tag, as an *option*, beginning with monthly RA compliance showings in July or August (see Section 4, below).

3. Changes to Current RA Compliance

At the stakeholder meeting, the CAISO indicated that implementation of the SCP may require some small changes to the RA compliance filings or templates for the CPUC-jurisdictional LSEs. AReM requests that the CAISO coordinate what those changes would be with CPUC staff and make such proposed changes clear in the CAISO's updated straw proposal

¹ AReM is a California non-profit mutual benefit corporation formed by electric service providers that are active in the California's direct access market. This filing represents the position of AReM, but not necessarily that of a particular member or any affiliates of its members with respect to the issues addressed herein.

4. Optional SCP Tags for 2009 Monthly RA Compliance

The CAISO has proposed that use of SCP Tags should be mandatory for RA compliance, but that they could not be in place in time for monthly RA compliance for 2009. AReM does not object to the idea that the use of SCP tags will become mandatory as long as legitimate transition issues are taken into account. However, AReM requests that the use of the SCP Tags be allowed as an *option* for 2009 monthly RA compliance. AReM envisions that this approach would not create significant issues, because the CAISO has already indicated, as noted in #3 above, that implementation of SCP will not require significant changes to RA compliance showings. Thus, an LSE would have the option to continue to list its contract ID for a bilateral agreement as it does today in its monthly filing and would have the additional option of meeting part of its monthly RA obligation through SCP Tags that would be listed in the template. Specific transition issues may have to be addressed for contracts that were entered into before implementation of SCP and with respect to the DWR liquidated damages contracts.

5. QC Testing Protocols

The CAISO tariff should contain explicit rules and protocols associated with annual (or seasonal) testing of capacity resources. Those tests should form the basis for a resource's NQC that is then fixed for a year. AReM does not object if the NQC determinations as a result of these testing protocols reflect NQC values that differ seasonally, as long as the NQC for the entire year is known in advance of the first compliance showing. AReM further agrees that the tested QC of the unit that is eligible for RA should be derated by the CAISO to match the units interconnect rating and for deliverability, but should not be derated for outages, as those will be accounted for in the availability and performance metrics. AReM believes that the addition of testing protocols to the MRTU Tariff should be easily and quickly accomplished. However, if the CAISO can make a strong argument that adding these protocols would delay the February 2009 filing, AReM would agree that this item could be postponed.

6. Duration of NQC and SCP Tag

The CAISO's proposal states (p. 14) that the "duration" of the SCP Tag "extends no longer than the publication of the next NQC list." This language is confusing. The CAISO tariff needs to state clearly that the duration of the SCP Tag is for the RA compliance year, and likewise, the tariff needs to specify that NQC is fixed for the same RA compliance year.

7. Ancillary Services (AS) Must Offer Obligation (MOO)

AReM does not object to the RA MOO including a requirement to bid all ancillary services for which a resource is qualified, as long as reasonable rules are implemented that allow entities to modify their AS certifications as operating conditions require.

8. RA Less Than Pmin

AReM does not object to a tariff requirement that a unit that has sold less RA than its Pmin must nevertheless offer in at the Pmin.

9. Demand Response

AReM agrees that for RA purposes (i) dispatchable demand response resources should be counted as supply, (ii) NQC counting rules for demand response resources should be determined in CPUC proceedings and those counting conventions adopted by the CAISO, and (iii) if the counting conventions for demand response are based on availability metrics, then those resources should be exempt from in-period availability metrics and penalties, although, of course, those units are subject to the Must offer requirement.

10. Performance and Use of Target Availability Standard

The CAISO proposal to develop unit-by-unit availability targets should be abandoned. Instead, there should be further discussion to determine an availability standard that rewards units that are able to perform well and that leads to revenue reductions for those that do not. In this regard, it is important to note that, as long as the availability metric is known up front, resources owners of both high performing and low performing resources will be able to manage their portfolios. In other words, certainty about the metric is more important than the absolute value of the metric.

AReM is concerned that the CAISO's proposal to develop, maintain, re-calculate and enforce a "target availability standard" for each individual RA resource will be extremely time consuming, delay implementation, and ultimately increase costs for consumers. Further, the counting rules developed by each Local Regulatory Authority (LRA) to determine "Qualifying Capacity" for each resource, coupled with the CAISO's calculation of "Net Qualifying Capacity," already calculate an availability measure for certain resources such as wind and demand response, as mentioned above. In addition, the CPUC's adopted principle of "forced is forced" means that some level of non-performance is both expected and planned for. Whatever availability target is adopted, it must be designed to avoid double-penalizing resources or consumers.

At this point, AReM tends to believe that a peak period availability metric will be more effective and easier to implement than an availability metric that covers all hours.

11. Outages and the Availability Metrics

If the CAISO does not abandon the idea that each RA resource should have a separate availability target, as recommended above, then the CAISO should modify its proposal to exclude maintenance or overhaul outages from the calculation. The purpose of an availability metric is to provide an incentive for resources to avoid forced outages when the resource is most needed. All maintenance and overhaul outages are ultimately approved by the CAISO and so do not need to be and should not be included in this incentive mechanism.

12. Imports of Firm Energy and RA MOO Obligation

LSEs are allowed to count imports of Firm Energy (Firm LD contracts) as RA resources to the extent the LSE has an associated RA Import Allocation. Therefore, AReM agrees with the observation in the straw proposal that imports require special attention to clarify the concept of the RA MOO for such resources. In other words, how does the Firm Energy import make itself available to the CAISO markets, and if it fails to do so, who is penalized? Two alternatives should be considered.

In the first alternative, the LSE could remain responsible for performance for its RA resource. If the LSE has listed a Firm LD contract that supplies energy at the intertie that the LSE is using for RA compliance, then the RA MOO for the Firm LD contract is that it must be scheduled into the CAISO's control area for the requisite hours to match the hours the resource was counted toward the LSE's Maximum Cumulative Capacity (MCC). If the LSE fails to meet this RA MOO, it is subject to the RA penalty. For example, presume that an LSE has been allocated 10 MW of space at COB, and reports that 10 MW of space on its RA compliance report. Presume next that the availability target is established such that RA resources that are not available for 98% of the peak 500 hours must pay \$41/kW-year for every MW below the 98%. If the LSE who claimed the 10 MW of RA from the intertie only offers in or schedules energy in only 90% of the peak hours, that LSE will be required to pay the established penalty for the 8% of the hours it did not offer or schedule energy at the intertie. This alternative approach for imports would represent an exception to the general SCP principles that LSEs should have no RA availability obligations. This exception would be reasonable because, in the case of imports, the LSE acts as the owner of the RA resource by virtue of having accepted the intertie allocation and using it for RA compliance. The LSE will be able to manage this obligation through the energy purchases it makes to deliver energy to the intertie point.

In the second alternative, the supplier of the Firm Energy import could be treated the same as any other capacity resource. In this alternative, the RA supplier is obligated to meet the RA MOO by bidding or scheduling the RA quantity into the CAISO markets at the intertie. Further, the supplier would be obligated to meet the performance requirement set by the CAISO and would have to pay the associated penalty if it fails. If imports can meet these same requirements as an internal RA supplier, then they can be treated the same and would require no special exceptions. Stakeholders should discuss which of these two alternatives is more workable for the RA market.

13. Performance Incentive Structure

At this time, AReM supports the in-period financial penalty structure for the SCP, rather than the approach that would prospectively reduce a unit's NQC. If and when a capacity market structure is put in place, consideration can be given to adopting the UCAP approach used in the eastern markets, where forced outages prospectively reduce NQC. Absent a capacity market structure, the prospective approach is ill-advised because the risks associated with that structure are much less hedgeable and therefore will impose costly risks that can be avoided by using the financial penalty approach. AReM also believes that the CAISO's analysis that the prospective approach creates stronger incentives to maintain availability is not consistent with commercial realities; both a financial penalty structure and prospective decreases to NQC provide equivalent performance incentives. Finally, the CAISO's analysis that the level of the financial penalty must be a function of the price paid by the LSE for the capacity is likewise unfounded in commercial realities, as discussed during the stakeholder meeting, and should be eliminated from the proposal.

14. Transition/Grandfathering

Because the CAISO is proposing to change the current RA MOO to require all AS-certified RA resources to bid into the AS markets, this additional requirement is likely not captured in any of the existing RA bilateral contracts. AReM notes, however, that this issue is *not* tied to the SCP *per se*, but to the CAISO's decision to change the RA MOO, which is linked to the issue of scarcity pricing. Whenever the CAISO elects to change any underlying RA provision, such as RA MOO, it will face the issue of existing bilateral contracts that then become non-compliant, even though the contracts were entered into in good faith with the intent of meeting the RA requirements. Consequently, AReM believes that certain existing multi-year contracts may legitimately require some transition accommodations, but such accommodations should extend no longer than the duration of their *initial* contract term.

15. Credit

The CAISO needs to provide further explanation as to why credit support is required from RA suppliers who may be subject to performance penalties. If the CAISO pursues this feature of its proposal, it must show how all entities that are subject to penalty provisions of the CAISO tariff are also subject to credit posting requirements.

*Submitted by:
Sue Mara
RTOAdvisors, L.L.C.
On Behalf of AReM*