COMMENTS OF THE
ALLIANCE FOR RETAIL ENERGY MARKETS
ON THE CAISO's JULY 15, 2010 STRAW PROPOSAL
REGARDING CAPACITY PROCUREMENT MECHANISM (CPM)

The Alliance for Retail Energy Markets (AReM)[1] provides the following comments on the CAISO's Straw Proposal issued July 15, 2010 regarding a Capacity Procurement Mechanism (CPM) to replace the current Interim Capacity Procurement Mechanism (ICPM).

1. PRICING OF CPM

a. Sending A Price Signal With CPM Pricing

AReM strongly supports vibrant competitive wholesale and retail markets and well recognizes the flaws in the current hybrid market structure. The CAISO proposes an option for CPM pricing based on an administratively-determined value of cost of new entry (CONE).[2] While AReM supports the concept of sending price signals for new investment, short-term CPM backstop procurement mechanism is not the appropriate vehicle and could lead to significant market misallocation of costs if adopted without coordination and reform of certain other aspects of the current hybrid market structure, such as the California Public Utilities Commission's (CPUC) Resource Adequacy (RA) program. Instead, if the CAISO desires to send such a price signal to the market, then it should develop and implement a centralized capacity market, which would provide the appropriate market structure and ensure equal treatment for all market participants.

b. Interaction of CPM and the CPUC's RA Program

As the CAISO suggests, the price of backstop procurement drives prices in the RA capacity market, as does interaction between CAISO backstop procurement and RA penalties imposed by the CPUC. AReM urges the CAISO to consider these interactions when adopting its pricing mechanism for CPM.

c. Cost of New Entry (CONE) – Option A

Like ICPM, the CAISO proposes to use CPM as a backstop procurement mechanism for RA and to procure small amounts of short-term capacity for "Exceptional Dispatch." (The CAISO's proposal to expand this service to other uses is discussed below.) First and foremost, AReM would urge that any time the CAISO is in a position of having to do any significant amount of backstop procurement, that is a strong signal that there are some fundamental problems with the structure of the RA program, either in terms of how the RA needs have been defined or with respect to the planning reserve margin. To ensure that such fundamental flaws are addressed, any procurement by the CAISO should be accompanied by a full explanation as to the events that created the need for backstop procurement. To the extent that the backstop procurement is necessary to meet unanticipated, short-term needs, CONE may be an inappropriate price for this service, as recognized by FERC in its 2008 ICPM decision, when it rejected CONE pricing in circumstances where ICPM was used for

[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.

[2] AReM understands that the CAISO is proposing an administratively-set price based on net CONE for Option A. Several references in the Straw Proposal to "clearing" of the prices under Option A were confusing and should be clarified or corrected in the next version of the paper.

backstop capacity needed for short periods to meet system reliability needs and "therefore, is not designed to encourage new investment."[3]

d. Sealed Bids As An Alternative To CONE

In the 2007 debate on ICPM, AReM and other parties supported using sealed bids to set the price for this service.[4] AReM supported the concept of sealed bids as the preferred approach for ICPM pricing primarily because this was the sole option proposed that *should not* drive the prices and compete against resource availability in the RA market if implemented properly. AReM also proposed a process for implementing the approach. AReM urges the CAISO give this proposal serious consideration at this time.

e. Update to Current ICPM Price -- Option B

If the CAISO chooses not to adopt the sealed-bid approach or adopts a methodology that interferes with the pricing interplay between ICPM and the CPUC's RA program, AReM will support Option B, which sets the CPM price based on the current ICPM price updated for inflation. AReM is prepared to work with the CAISO and stakeholders to determine the best means of calculating this adjustment.

2. RA CREDITS FOR CPM PROCUREMENT

AReM requests (as it did in 2007)[5] that the CAISO provide LSEs (and their customers) with RA credits for any CPM payments. Paying for capacity without receiving RA credits leads to over-procurement by LSEs and unnecessary costs for California consumers. AReM urges the CAISO to add this feature to its proposal.

3. PROPOSED EXPANSION OF BACKSTOP SERVICE

The CAISO Straw Proposal recommends a vast expansion of its CPM authority, including procurement to integrate renewables, avoid retirement of needed units, make up for planned outages, and make up for non-delivery by intermittent units. AReM strongly opposes this expanded authority for the reasons stated above – that the planning reserve margin is intended to provide for many contingencies, and that expansive use of backstop procurement authority circumvents the development of a robust RA program. Moreover, the CAISO must explain why its stated needs cannot be met through other market-based means, such as new products or capacity auctions developed by the CAISO for this purpose. In short, AReM cannot support the CAISO's proposed expansion of CPM service unless the CAISO provides substantial and compelling evidence documenting why such service cannot be provided by such other market-based approaches.

Submitted by:
Sue Mara
RTOAdvisors, L.L.C.
On Behalf of AReM
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[3] 125 FERC ¶61,053, October 16, 2008, ¶ 41.
[4] AReM's October 24, 2007 Comments, pp. 3-5.
[5] AReM's October 24, 2007 Comments, pp. 8-9 and AReM's November 20, 2007 Comments on the ICPM Final Proposal, pp. 1-2.