

MEMORANDUM

From: Bilateral Trading Group

To: kperez@caiso.com

Date: November 7, 2007

Re: MSC Opinion on “Long Term Resource Adequacy under MRTU,” dated 11/5/07

The Bilateral Trading Group (BTG)¹ provides the following brief comments on the above-cited Market Surveillance Committee (MSC) opinion. BTG applauds the MSC for its prudent approach to long-term resource adequacy (RA). The MSC has appropriately recognized that there is great uncertainty in the California electricity market pending the implementation of numerous significant market changes with the implementation of the California Independent System Operator’s (CAISO’s) Market Redesign and Technology Update (MRTU) next year. The MSC has also taken into account the fact that the performance of new centralized capacity market structures in the Eastern United States is in its very preliminary stages and has not produced any definite results in terms of its ability to stimulate the construction of new generation capacity. In addition, the MSC has noted the successes of the current RA paradigm in meeting reliability needs since the California energy crisis of 2000-2001. These are all important considerations in determining whether to make yet another, substantial, change in procurement of electric generation resources in the State.

The MSC has properly noted that there are several major policy initiatives being pursued in California that do not appear to be compatible with the development of a centralized capacity market in the near future. These include the renewable portfolio standard, a priority for energy efficiency implementation, greenhouse gas mitigation, and a review of the reintroduction of retail choice. As the Opinion notes, “the combination of new environmental mandates and the transition to MRTU cast a great deal of uncertainty over the questions of both *how much* capacity California needs and what this capacity must *do*.” (Opinion, p. 4) There is a significant risk that the implementation of a centralized capacity market could result in payments for significant amounts of generic generation capacity that are not compatible with what will be needed as these policies are implemented. New resources must be targeted to complement the renewable resources, demand-side resources, and energy efficiency results that come to pass over the next decade. No current capacity market proposal before the California Public Utilities Commission and the CAISO even attempts to address these needs.

¹ Bilateral Trading Group (BTG) includes APS Energy Services, the California Electricity Oversight Board, the California Large Energy Consumers Association (CLECA), the California Manufacturers and Technology Association (CMTA), the City and County of San Francisco (CCSF), Coral Power, L.L.C., the Division of Ratepayer Advocates (DRA), the Energy Users Forum, J. Aron & Company, The Utility Reform Network (TURN), and Strategic Energy, L.L.C.

The success of the new centralized capacity markets being implemented in the Eastern RTOs is far from certain. The results to date do not demonstrate success in stimulating any significant amount of new generation capacity. Furthermore, these markets are not designed to provide resources that are compatible with the kind of policy goals discussed above. Indeed, to date, the implementation of these markets has been characterized by substantial increases in payments to existing generators without any promise of stimulating desirable forms of new generation. Furthermore, there is no evidence that paying higher prices for capacity to existing generators results in reinvestment in new generation.

The MSC's recommendation of refinement of the current RA paradigm strikes us as precisely the proper course to pursue in the midst of all this policy and market change. CLECA and CMTA have strongly supported the development of a standardized long-term capacity product to facilitate trading in secondary markets and to allow capacity to follow load if it is served by different suppliers over time. We regret that the CAISO has indicated that it feels unable to pursue the set of tariff changes which many parties believe are important to the implementation of a standardized capacity product before 2009, when such a product is so central to a more efficient market. We also agree with the MSC that the CAISO may meet some of its future operational needs by defining and procuring additional ancillary resources. These are likely to include quick start and greater ramping capability, as well as black start and voltage support. We are also interested in the MSC's proposal to reintroduce the concept of replacement reserve.

BTG supports the conclusions of the MSC that there should be significant forward procurement to hedge end use demand against short-term energy price risk, that this procurement should be able to be pursued competitively, and that, given California's dependence on hydroelectric power and increasingly on intermittent output from renewable facilities, energy adequacy is at least as important, if not more so, than capacity adequacy. Indeed, we supported a more energy-based proposal during the CPUC's RA proceeding.

Lastly, BTG supports the conclusion that demand must play a very significant role in the energy markets in order to mitigate market power and send the message that "reliability at any price" is not the future that the consumers of electricity prefer. Our hope is that through the implementation of advanced metering and dynamic pricing, as well as a good linkage between wholesale scarcity pricing and retail price signals, such a role will be achieved in the not-too-distant future.