CALIFORNIA ISO
CAPACITY PROCUREMENT MECHANISM AND COMPENSATION AND BID MITIGATION FOR EXCEPTIONAL DISPATCH

COMMENTS OF THE STAFF OF THE

CALIFORNIA PUBLIC UTILITIES COMMISSION

Capacity Procurement Mechanism Draft Tariff Language

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October 29, 2010

The Staff of the California Public Utilities Commission ("CPUC Staff") submits the following comments on the draft tariff language for the Capacity Procurement Mechanism (CPM) published on October 20 and 22, 2010. In their prior comments on this initiative submitted on June 24, July 30, and September 3 and 29, 2010, CPUC Staff indicated their lack of support for certain aspects of the initiative. These comments will not be fully repeated here, but several points are briefly noted:

- The CAISO's proposal goes beyond the conventional understanding of the purpose and function of the backstop, to offer up to a 12-month CPM designation contract for generation units that the CAISO believes are needed for reliability, but may shut down due to insufficient revenues. This conflicts with State and federal law directing that California's long-term procurement and resource adequacy requirements are established by State laws and policies. The CPUC has established and operated a successful Resource Adequacy (RA) program that has resulted in drastic reductions in CAISO out-of-market procurement. The CPM should be used only for incremental or unanticipated reliability needs that are not fulfilled through the CPUC's RA procurement process.
- The CAISO's proposed CPM designation for units in danger of shutting down is inconsistent with efficient market design principles, where generating resources deemed unnecessary are allowed to leave the market.
- In any event, this proposal is unnecessary because a mechanism to retain and compensate units needed for reliability already exists. The operation and

maintenance standards in CPUC General Order 167 apply (with some limited exceptions) to *all* electric generating facilities located in California, inclusive non-utility generation.[1] Operating Standard 24 requires resources to maintain their units in a state of "readiness" unless the CPUC (in consultation with the CAISO) has determined that they are not needed. Operating Standard 24 recognizes that there must be just compensation provided to any resource for the "readiness" requirement. The consultation process called for under Operating Standard 24 allows the CAISO and the CPUC to work together to ensure that needed resources are adequately compensated and not retired prematurely.

- The proposal also presents a gaming opportunity for a plant seeking to leverage a CPM designation through a threat of retirement of the unit.[2] A generator may be able to predict its importance to the grid based on past history, its location in a Local Area or Subarea, or information from the various planning processes. A generator could then threaten to retire in order to receive a CPM designation at a price higher than the current market for capacity. In the present market, it is clear some generators are currently willing to enter in RA contracts with LSEs below the current $41/kw-yr backstop price, let alone the $55/kw-yr proposed for CPM. The CAISO's Market Surveillance Committee has acknowledged that a 12-month designation can create an incentive for units to threaten to retire and the "CPM payment can influence RA prices."[3]
  - In addition, many generating resources, particularly older and less efficient ones in Local Areas, are typically part of a fleet of resources owned by affiliated companies. Affiliated companies could assign ownership of an individual resource to a particular entity to support a claim for economic subsidy, regardless of the overall profitability of other resources owned or operated by affiliated entities.
- It is also not clear that the CAISO can accurately predict what capacity will be needed over the next two years to justify up to a 12-month CPM designation without relying on data from the year's Local Capacity Technical Analysis (LCR) study, which may not be available at the time the CAISO makes the determination of whether to offer a CPM designation. The LCR study provides the basis for single-year Local RA obligations for the next compliance year.
- The proposed process to conduct due diligence to justify up to a 12-month CPM designation cannot support a legitimate determination regarding the financial status of the generator. The substance of the required affidavit and financial

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[1] *See* Cal. Pub. Util. Code § 761.3(a); General Order 167, § 2.9 (Definition of "Generating Asset Owner;" and CPUC Decision D.06-06-069 upheld the legality of Operating Standards 22, 23 and 24.

[2] See also the Opinion on the Capacity Procurement Mechanism and Compensation and Bid Mitigation for Exceptional Dispatch, F. Wolak, J. Bushnell, B. Hobbs, CAISO Market Surveillance Committee (October 18, 2010) p. 4.

[3] Market Surveillance Committee Opinion, *supra*, (Oct. 18, 2010), pp. 3-4.

documentation, are not clearly defined, including the standards governing the supporting documentation (e.g., Generally Accepted Accounting Principles (GAAP), Financial Accounting Standards Board (FASP) or Sarbanes Oxley). Similarly, no standards are described for determination of whether a resource should be economically subsidized; the lack of a transparent or objective process is in stark contrast to the review processes to test and verify other claims made by generators, such as PMax or deliverability. Moreover, generation unit owners' calculation of expected market revenues will be based on subjective and speculative assumptions.

- CPUC supports not using a higher level of payment for CPM, such as CONE. CPM is for short-term backstop procurement, not to incent investment. The proposed $55/kW-year prices is above prices observed in the current capacity markets and therefore risks raising prices for capacity in the CPUC's RA program.
- The CPM should have a two-year sunset because of numerous pending market design changes.

For the above reasons, the CPUC respectfully requests that the CAISO withdraw sections 43.2.6, 43.3.7, and 43.8.7 of its Draft Tariff Language before submitting to FERC for approval.

Contacts:

Donald Brooks, Energy Division, dbr@cpuc.ca.gov
Charlyn Hook, Legal Division, chh@cpuc.ca.gov