INDEPENDENT ENERGY PRODUCERS

March 23, 2012

To: **CAISO**

From: **Steven Kelly**
Policy Director

Date: **March 23, 2012**
RE: **CAISO Flexible Ramping Product Cost Allocation Straw Proposal**

The Independent Energy Producers Association ("IEP") is please to provide the following comments regarding the CAISO's Flexible Ramping Product Coast Allocation Straw Proposal. IEP participated in the CAISO Stakeholder Meeting on March 16, 2012; and, those comments are incorporated herein.

The CAISO's Flexible Ramping Product Cost Allocation Straw Proposal contains a number of critical design features. IEP focuses its comments on the following key design features:

1. **Determination of Deviations for Which a Flexible Ramping Product Will Be Needed.** While additional information is required, IEP at this point supports further consideration of the proposal to allocate costs based upon "expected potential deviations across all market participants."

2. **Hourly Profile for PIRP Real-Time Self Schedule.** While additional information is required, IEP at this point supports enabling self-scheduled PIRP resources and intermittent renewable resources to adjust their schedules closer to real time. As IEP understands the proposal, these resources will be allowed to revise their schedules 37.5 minutes prior to the 'binding RTPD interval." This is an improvement over the status quo, but we recommend on working narrowing the time-gap between final schedules and the operating hour as much as feasible.

3. **Netting Proposal and Comparable Treatment.** The Straw Proposal proposes to net deviations for load and generation. The netting proposals must be comparable across loads and generation both in terms of the time over-which the netting occurs and in terms the relative impacts.

4. **Cost Allocation.**

The straw proposal would allocate the costs of flexible ramping to Scheduling Coordinators ("SC"). More specifically, the proposal is to "implement functionality to allow assignment of the flexible ramping product cost allocation at the resource level." (Straw Proposal, p. 9)

In parallel, as part of a separate stakeholder process, IEP filed comments on the CAISO's Cost Allocation Guiding Principles Draft Final Proposal. IEP comments submitted in response to the CAISO's Cost Allocation Guiding Principles Draft Final Proposal relate to our concerns regarding this matter. Because the same issues(s) in whole or in part are presented in the discussion of Flexible Ramping Cost Allocation, we wish to incorporate our comments on Cost Allocation Guiding Principles by reference, and we re-state the following:

Comments on CAISO Proposed Cost Allocation Guiding Principles.

The Draft Final Cost Allocation Guiding Principles provide additional guidance to market participants when considering how best to allocate CAISO market costs. The Guiding Principles, however, will only affect future resource choices, and will have little impact on decisions already taken. Accordingly, IEP reiterates its concerns that the application of the Guiding Principles in a retroactive manner (a) will not send proper price signals to incentivize behavior where decisions have already been made, it will only make the management of existing resources that much more problematic; (b) may not result in cost allocation to those best able to manage the costs; and (c) may not properly allocate costs responsibility for CAISO market costs to those entities that bear responsibility for procurement decisions that gave rise to these costs, but rather it will reward LSEs for poor procurement practices in the past.

Causation. As noted in prior IEP comments, nearly all development decisions in the California today are driven by long-term power purchase agreements and/or rate-based commitments for utility-owned generation. Thus, the root "cause" of poor procurement decisions rests with the LSEs and their procurement practices, rather than with the generators and their operational characteristics matched to their contractual obligations. The solution, therefore, is to incent better LSE procurement practices going-forward. To the extent that CAISO related costs should be borne by generators in order to incent better LSE procurement practices, then a reasonable means of cost-recovery for CAISO incurred costs (if any) must be made available *prior to any transition* to an environment in which such costs are imposed directly on generators. Otherwise, the CAISO risks undermining grid reliability as electric generators face costs for which they have no reasonable means of cost recovery.

IEP appreciates the CAISO's desire to apply the principle of Causation as a means to incentivize behavior. As an example, the CAISO indicates a "key tenant behind locational marginal pricing market design, in which energy prices reflect a generating unit's contribution to exacerbating or relieving transmission congestion." (p. 5) In response, IEP notes that the application of this principle relies on two facts, neither of which prevail in the CAISO's service territory today: first, locational marginal pricing must be the primary signal driving procurement decisions, which is not the case today; and, second, price signals to relieve transmission congestion must be known in advance over the term of a long-term power purchase agreement (e.g. 20 years), which is not the case today. Requiring individual generators to bear the risk of changes in the potential costs for procurement decisions made in the absence of such long-term price signals imposes an unjust and unnecessary burden on the generators. Furthermore, on a going-forward basis, it imposes unneeded additional costs on ratepayers as *all* developers will have to bid into each LSE Request for Offers ("RFO") the *risk* that these unknown and unknowable costs may be borne by their facility over the term of the long-term contract.

Accurate Price Signals. IEP supports this principle. However, we note that providing accurate price signals has multiple components. First, the CAISO should help send accurate price signals to LSEs who are making the key procurement decisions that incent generator operations and/or development. Second, sending accurate price signals only makes sense the extent to which generators may respond to them. Once LSEs enter into contracts with electric generators, generators have little opportunity to modify their operations outside the terms and conditions of the contract.

Incentivize Behavior. IEP supports this principle. However, as previously noted, once LSEs enter into contracts with electric generators, generators have little opportunity to modify their operations outside the terms and conditions of the contract. The critical goal, given the nature of California's energy markets and procurement practices for the foreseeable future, is to incentivize better LSE procurement behavior.

Manageable. IEP supports this principle and believes it is the most critical principle to the success of this endeavor. As noted by the CAISO, "Market participants should have the ability to manage exposure to the allocation." This reflects a critical concern we have expressed previously in comments. In light of this concern, the CAISO recognizes "that transitional measures may need to be assessed to allow sufficient time for market participants to implement within contractual arrangements." IEP strongly supports this observation, but believes that an effective and reasonable transition is a condition precedent for moving forward with the goal of shifting CAISO market cost responsibility from LSEs to generators. [Below we provide a specific proposal to manage this transition.]

5. **Proposal to Manage Transition To Environment in Which Cost Responsibility for CAISO Market Costs Shift from LSEs to Generators**

In the Stakeholder meeting, the CAISO staff requested suggestions for transitional mechanism in light of the existing realities. In response, IEP notes that LSEs were the primary drivers of the existing resource base, the vast majority of which operate under existing contracts; and, the LSEs will continue to be the key decision-makers driving future generation additions, i.e. the what, where, when.

Moreover, given the reality of this mix of resources and the continuing importance of LSE procurement practices in resource selection, IEP suggests the need for the following policy, as a *condition precedent*, to rationally move a market design in which CAISO-related market procurement costs are shifted from LSEs to generators without undermining neither existing commercial transactions nor grid reliability:

1. Currently, the LSEs bear the costs for most, if not all, the market products procured by the CAISO to maintain overall grid reliability, including backstop procurement. Continue to allocate these costs to LSEs during the transition to the new paradigm.

2. If an LSE offers a contract term providing full cost-recovery of CAISO market costs to a generator, but the generator declines accepting that contractual term; then, CAISO cost allocation shifts from the LSE to the generator.

3. If an LSE offers a contract term providing full cost-recovery of CAISO market costs to a generator, and the generator accepts the contractual term; then, CAISO cost allocation shifts from the LSE to the generator upon finalization of the contract term.

We appreciate your consideration of these matters.

Respectfully submitted,

Steven Kelly
Policy Director