Comments of J.P. Morgan Ventures Energy Corporation
Subject: CAISO's Standard Capacity Product Straw Proposal

Submitted by	Company	Date Submitted
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J.P. Morgan Ventures Energy Corporation (J.P. Morgan) appreciates this opportunity to comments on the California ISO's (CAISO's) Standard Resource Adequacy Capacity Product (SCP) straw proposal, as outlined in the CAISO's November 11, 2008, Straw Proposal and as discussed at the November 18, 2008, SCP stakeholder meeting. J.P. Morgan continues to support the development of a SCP and the objective of finalizing development of the SCP and submitting it for approval by FERC in early 2009. J.P. Morgan supports development and implementation of a SCP to facilitate the development of a viable and transparently-priced market for needed capacity. J.P. Morgan believes that development of a SCP, if done correctly, can be an important building block towards establishing a robust long-term resource adequacy program in California.

In addition, J.P. Morgan agrees with the CAISO's proposal to defer development of certain features (bulletin board, resource registry) and to minimize necessary changes to the existing established resource adequacy rules (e.g., counting conventions).

<u>Grandfathering</u>

- ***J.P. Morgan recommends that the CAISO grandfather all existing resource adequacy contracts for the full term of the contract and that the full value (NQC MW) of the resource be appropriately maintained through the term of the contract.***

J.P. Morgan strongly supports full "grandfathering" of existing resource adequacy contracts under any SCP proposal. J.P. Morgan is party to a number of resource adequacy contracts regarding the sale of capacity and energy from generating resources located within the CAISO system and within CAISO-identified local capacity areas. The resources in question are contracted to provide resource adequacy capacity. These resource adequacy contracts are currently used to satisfy the applicable counterparty load-serving entity's resource adequacy obligations. In addition, each of the contracts already contains provisions regarding the expected availability of the affected resources and consequences for non-performance. Should the CAISO implement a Net Qualifying Capacity (NQC) adjustment-based approach to assessing performance penalties, J.P. Morgan believes that the full value (MW) of these existing resource adequacy contracts must be maintained as part of any transition plan developed and implemented in conjunction with a SCP. Specifically, J.P. Morgan recommends *all* existing resource adequacy contracts should continue to count towards satisfying all applicable resource adequacy requirements for the *full term* of the contract based on the Net Qualifying Capacity (NQC) established by the CAISO for the underlying resource for the 2009 compliance year (i.e., the CAISO NQC number published for the resource in 2008 for the 2009 resource adequacy compliance period). Absent changes to a resource's NQC that are the result of a change in a Local Regulatory Authority's counting rules or application of the CAISO current (2008) NQC methodology, that resource's NQC value will not be changed by the CAISO until the applicable resource adequacy contract has expired or has otherwise been terminated by the parties. Parties to existing resource adequacy contracts should provide the CAISO with both the term of the contract and identify the applicable capacity resource(s). The CAISO can then "flag" all such identified resources on its NQC list to ensure that the appropriate NQC values are maintained through the term of the contract.

Alternatively, if, as suggested by J.P. Morgan below, the CAISO implements a financial penalty based performance penalty system, the CAISO should ensure that any such developed penalties are not charged to existing grandfathered resource adequacy contracts. As stated above, these existing resource adequacy contracts already contain performance-related penalties or consequences.

J.P. Morgan presumes that implementation of this approach will not be problematic because the CAISO will be monitoring and assessing any SCP-related performance standards and penalties after the fact using off-line systems. J.P. Morgan appreciates there may be more implementation challenges regarding the resource adequacy must-offer obligation and its potential non-application to grandfathered contracts. J.P. Morgan requests that the CAISO provide further information regarding potential grandfathering implementation constraints.

Availability Standards

- ***J.P. Morgan recommends that the CAISO adopt a single availability standard that is based on, and consistent with, the CAISO's operating requirements.***
- ***J.P. Morgan recommends that the CAISO adopt an availability metric that establishes incentives for resources to be available when needed by the CAISO and to improve their overall availability performance.***

The CAISO's straw proposal proposes to establish an annual yearly availability requirement (hours) for each resource based on that specific resource's average availability over the past five years. Each resource will be required to provide NERC GADS data to the CAISO to set the requirement. In addition, the CAISO also proposes to establish a peak hours availability requirement (5 peak hours of each day based on season).

First, J.P. Morgan does not support the development of multiple availability standards, e.g., a requirement based on a resource's availability *all hours* of the year and a standard that is tied to a resource's availability during the *peak hours* of the year. J.P. Morgan recommends that the CAISO establish an availability metric that is based the period of time capacity is most valuable to the CAISO. If the CAISO place the greatest value on capacity that is available year round, then an all-hours standard should be adopted. Alternatively, if the CAISO wants capacity at peak to serve load, then a peak-hours standard is appropriate. J.P. Morgan is unclear how the CAISO would apply a two-tiered standard and is concerned that resources may be inappropriately penalized twice for non-performance.

Second, J.P. Morgan agrees with the comments made by NRG Energy, the California Capacity Forward Market Advocates (CFCMA), and other parties at the November 18, 2008, stakeholder meeting that, at least conceptually, an availability standard that is based on and tied to a *system or fleet-wide* performance is more appropriate than a standard that is based on a individual resource's specific historic availability and performance. The CAISO's objective should be to establish an availability standard that encourages and rewards availability and to improve system performance – not maintenance of the status quo. Availability should be measured by the number of hours a resource is not available due to forced outages and the availability factor should explicitly exclude hours in which the resource is offline due to scheduled maintenance. J.P. Morgan does agree comparison of availability during a performance period to rolling multi-year historical average is appropriate in order to reduce the impact of poor performance during one performance period.

J.P. Morgan is encouraged that the CAISO is examining the standards and practices in place in the organized electricity markets that have established capacity markets. To the extent possible, J.P. Morgan recommends that the CAISO not "reinvent the wheel" and adopt the generally accepted capacity availability standards in place in other markets. J.P. Morgan agrees with the comments expressed by certain parties that it is not essential that the CAISO undertake an extensive study or detailed analysis to arrive at an availability standard. In general, J.P. Morgan supports the adoption of an availability standard that requires resources to be available to the CAISO a high percentage (e.g., 90) of the hours (be it an all-hours metric or a peak hours metric).

Furthermore, J.P. Morgan believes that such a standard is appropriately applied to *all capacity* (resource adequacy) resources. Existing resource adequacy qualifying or counting conventions already – or should – account for and reflect the capacity values of different resource types (e.g., intermittent and energy limited resources should have a lower capacity value that a gas turbine peaker or gas-fired steam resource). Once their capacity value is established, all capacity resources should be required to be available to the CAISO on a comparable basis. J.P. Morgan agrees with the comment of parties that establishing a common (and high) availability standard does not affect the market value (dispatch) of a resource in providing energy or in any way disadvantage certain resources in the CAISO's markets. Availability standards are just that – measures of a capacity resource's availability to the CAISO to serve load and satisfy operating reliability requirements.

Performance Penalties

- ***J.P. Morgan supports the development and application of financial penalties to those resources that fail satisfy established availability standards.***

The CAISO SCP straw proposal identifies the need to apply performance penalties to provide an incentive for each resource to meet its target availability standard. While the CAISO straw proposal does not make a recommendation on the form of performance penalty, the CAISO states that such performance measures will be either financial penalties or an adjustment to NQC for the next compliance year.

J.P. Morgan supports the application of performance penalties to those resources that fail to satisfy applicable available standards. At present, and based on its understanding of the issues, J.P. Morgan supports the adoption and imposition of *financial* penalties on those resources that fail to satisfy adopted availability standards. J.P. Morgan believes the development and implementation of a financial penalty regime is feasible in the timeframe associated with the SCP development process. More importantly, J.P. Morgan believes that implementation of a financial penalty based system is workable under today's resource adequacy construct. J.P. Morgan finds compelling the concerns raised by NRG Energy, CFCMA and others that implementation of a NQC-adjustment based system may impose an unreasonable burden on suppliers (or potentially load-serving entities) that are forced to find replacement capacity when no such capacity market or trading platform exists. J.P. Morgan believes that such concerns are amplified when one considers the difficulties in acquiring the small amounts of capacity that may be needed to offset any potential NQC derates. Moreover, procurement and management of these additional incremental amounts of capacity will be made that much more complicated if market participants are required to bilaterally procure incremental slivers of capacity and the CAISO is required to register, track and enforce the SCP requirements on these additional capacity "resources". In addition, adjustments to a resource's NQC also raises potential challenges to implementation of the must offer obligation. While a resources NQC is adjusted, its actual unadjusted capacity still exists, but is just not (or should not) be available under the resource adequacy must-offer obligation. While further analysis is needed, this further fragmentation of resource adequacy and non-resource adequacy capacity may make the system unworkable. Therefore, J.P. Morgan cautions the CAISO that while an NQC-adjustment based methodology may appear to be consistent with the existing resource adequacy program and easy to implement, implementation of such a program is likely to be very difficult and has the potential to impose unreasonable and unnecessary burdens on participants.

Perhaps more importantly, J.P. Morgan agrees with the comments of Calpine and others that application of in-period financial penalties is equally effective at providing incentives for capacity resources to be available. While further consideration of an appropriate financial penalty is appropriate, J.P. Morgan agrees with certain parties that the readily available, FERC-approved, Interim Capacity Procurement Mechanism (ICPM) rate of $41/kW-year is a reasonable starting place for a financial penalty. In addition, a further benefit of a financial penalty based program is that financial penalty revenues could be used to reward capacity resources that exceed the established availability metrics during the compliance period.

Must Offer Requirement

- ***J.P. Morgan supports a generally applicable SCP requirement to offer all available energy and ancillary services into the CAISO's markets.***
- ***J.P. Morgan does not support any exemptions to the must offer obligation.***

As part of the SCP straw proposal, the CAISO proposes to expand the current resource adequacy must-offer obligation to include a requirement to offer both all available energy and ancillary services.

J.P. Morgan generally supports the obligation for capacity resources to offer all available energy and ancillary services into the CAISO day-ahead market and Residual Unit Commitment (RUC) process. However, only that capacity designated as resource adequacy capacity should be subject to the must offer obligation. While a unit or resource may have available capacity in excess of that committed under a resource adequacy contract, a resource owner should only be obligated to offer to the CAISO that capacity covered by a resource adequacy contract. Since the CAISO is already capable of handling "partial" resource adequacy resources, the CAISO should be able to accommodate this restriction. J.P. Morgan understands the CAISO's proposal to be consistent with this limitation.

J.P. Morgan believes that the SCP must-offer obligation should apply equally to all resources and resource types. J.P. Morgan does not agree that hydroelectric resources – be they run of the river, pumped storage, or otherwise – should be entitled to exemption from this rule. The CAISO already accommodates the usage requirements of energy-limited resources by permitting such resources to submit annual resource plans that enable the owners of such resources to manage their energy limitations. At a minimum, such resources should be capable of offering ancillary services capacity on a basis consistent with, and at a level up to, the energy bids they submit into the CAISO markets (and presumably their related resource plans). In addition, absent any evidence to the contrary, it is not obvious that such resource owners cannot submit energy and ancillary service bids at a level consistent with their desired use or use limitations. In other words, the energy and ancillary service offer caps should provide these resources with the flexibility they need to manage their use limitations (e.g., submission of $250 ancillary service bid indicates a desire not to be selected to provide ancillary services).

Similarly, it is not evident why demand response resources or other resources should not be subject to the offer obligation. Obviously, only those resources certified to provide ancillary services can have an obligation to offer those services. At this time, it is not clear the amount of demand response resources (other than flexible pumping resources) that have the ability to offer ancillary services, but J.P. Morgan presumes that it is a small volume. Likewise, and at present, J.P. Morgan does not support an exemption for imported resources. All resources, including imports, designated as available capacity should be offered in to the CAISO's markets as available energy, ancillary services or capacity.

Capacity Tags

- ***J.P. Morgan generally agrees with the CAISO's capacity "tag" construct and asks that the CAISO consider adding the data/information requirements necessary to honor grandfathered resource adequacy contracts.***

The CAISO proposes to create a standard capacity "tag" that is to be submitted to the CAISO to demonstrate compliance with the resource adequacy obligations. The tag will include a unique "resource id" to identify the capacity resource, the Net Qualifying Capacity (NQC) in MW of the resource, and the term of the tag.

J.P. Morgan supports the development of a standard capacity "tag", as proposed by the CAISO, understanding that the "tag" is essentially a new term for the three pieces of information (Resource ID, NQC, term) that comprise the tag and that are collected by the CAISO today. J.P. Morgan recommends that the CAISO consider including, as part of the tag, information regarding any capacity that is currently subject to an existing resource adequacy contract (MW, term) so that, consistent with its recommendations above, the CAISO can ensure that such capacity is not subject to the availability and performance provisions of the SCP program.

J.P. Morgan also supports the statements made at the November 18, 2008, stakeholder meeting that the CAISO should establish a more rigorous resource testing regime so as to further validate NQC values.

Credit Requirements

- ***J.P. Morgan supports the consideration of a Scheduling Coordinator's exposure to all CAISO administered penalties (including SCP performance penalties) when assessing its Estimated Aggregate Liability (EAL).***

Although not net detailed, the CAISO also intends to develop certain credit requirements to address the potential exposure to performance penalties. As stated in the CAISO's straw proposal the CAISO plans to consider a Scheduling Coordinator's potential exposure to performance penalties when evaluating that Scheduling Coordinator's Estimated Aggregate Liability of the Scheduling Coordinator and its related credit requirements.

J.P. Morgan agrees that the CAISO should consider a Scheduling Coordinator's exposure to all CAISO penalties as part of its EAL process. J.P. Morgan believes that in addition to any performance penalties developed as part of the SCP process, the CAISO must also consider a Scheduling Coordinators exposure to load under-scheduling penalties and any other CAISO administered penalties when determining a Scheduling Coordinators Estimated Aggregate Liability.

J.P. Morgan very much appreciates the opportunity to submit these comments on the CAISO's Standard Capacity Product Straw Proposal.