February 28th, 2011

Submitted by email to the CAISO at CostAllocation@caiso.com

RE: Comments of the Large-scale Solar Association on, "Cost Allocation Guiding Principles – Straw Proposal"

The Large-scale Solar Association (LSA) hereby submits these comments about the CAISO's February 14th document, **"Cost Allocation Guiding Principles – Straw Proposal"** (Proposal), and the discussion on a February 21st stakeholder conference call about the Proposal. The Proposal describes the CAISO's strategy for developing principles to use for cost allocation generally, and the application of those principles to specific CAISO products and services.

The CAISO is undertaking this initiative in order to craft a "holistic" response to cost-allocation issues that have arisen in many recent stakeholder processes. The Proposal states that the CAISO will address these issues in the following two-step process:

- **Develop a set of general cost-allocation "guiding principles," and apply these principles to the cost-allocation methodology for the Flexible Ramping Product** (FRP) now under development, which (together with the rest of the FRP product design) will be submitted for CAISO Board approval at the May meeting.
- **Commence an effort later this year to "review all current cost allocations"** and their compliance with the guiding principles, and adjust those allocations as appropriate.

LSA has major concerns about the Proposal, specifically: (1) the process/timing for development of the guiding principles, including their proposed near-term application to the FRP; and (2) the content of the draft principles themselves. The CAISO's proposed approach in the Proposal is fraught with problems, and LSA strongly recommends that the CAISO return to its prior proposal to use the Regulation cost-allocation methodology for FRP, pending the reasonable stakeholder process to examine cost allocation that it promised in the Renewables Integration - Market and Product Review, Phase 2 (RI-MPR2) process.

Process/timing for "guiding principles" development and FRP cost allocation

The October 11th RI-MPR2 document, Renewable Integration Market Vision and Roadmap, stated (at p.10) that the CAISO would initiate a separate, comprehensive effort to examine the issue of "cost causation" in a broader context, instead of examining that issue on a "product-by-product" basis. LSA supported that approach in its October 20th filed comments.

However, the FRP proposal that followed – the November 1st Flexible Ramping Products – Straw Proposal – would nevertheless have moved ahead with FRP-specific cost-allocation components, based on a complex six-part methodology using on different "buckets" and metrics for load and generation. The metrics for the latter would have been 5- and 10-minute deviations from constructed interval schedules, constructed from hourly schedules submitted long before real time.

After consideration of stakeholder comments, the CAISO reversed that position in the November 29th FRP Revised Straw Proposal, proposing to allocate FRP costs the same as Regulation costs (i.e., to load) but reporting on deviation metrics that could be used for cost-allocation later, pending the comprehensive cost-allocation examination promised in RI-MPR2. That cost-allocation proposal was maintained in the January 5th FRP Second Revised Straw Proposal (with a minor revision for load-following Metered Subsystems).

Now, at practically the last minute – when the FRP is approaching the Draft Final Proposal stage – the CAISO has suddenly reversed itself yet again, proposing to issue an entirely new FRP cost-allocation proposal, which stakeholders have not yet seen and will have only one opportunity to comment on. Simultaneously, the CAISO will rush through the promised "holistic and comprehensive" cost-allocation "examination," in less than two months, in order to justify whatever FRP cost-allocation proposal it comes up with, before the generic cost-allocation examination is even complete.

This is a shortsighted and flawed approach. LSA strongly supported a "holistic and comprehensive" cost-allocation examination in its RI-MPR2 comments, but that was based on the assumption that the CAISO actually meant to conduct a reasoned and reasonable stakeholder process for that initiative. However, the proposed timeframe is entirely insufficient to allow for any such reasoned effort.

This process should consider whether and how allocation of integratin costs could affect renewable-energy investment decisions in CPUC-jurisdictional Renewable Portfolio Standard (RPS) procurement processes, and how possible changes to other CPUC-jurisdictional programs (such as long-term procurement planning (LTPP) and the Resource Adequacy program) would affect those decisions. This examination alone would take time to conduct appropriately.

Moreover, as LSA said in its comments on the FRP Revised Straw Proposal, cost causation – just one of the proposed guiding principles – is a complex topic in and of itself, requiring isolation of incremental impacts of the many factors affecting load and supply variability. LSA's comments went on to note that "any cost-causation assessment should also consider beneficial impacts, e.g., the reduction in market energy prices that the CAISO seems to expect will occur as VER [Variable Energy Resource] penetration rises (as evidenced by its concern about the continuing economic viability of older gas-fired resources)."

The schedule set forth by the CAISO for finalization of the cost-allocation guiding principles is simply not sufficient to adequately explore even this one issue. Identification and development of the other principles should likewise be given more time than the CAISO schedule would allow.

The issue of FRP cost allocation was not seriously discussed in the FRP stakeholder process once the CAISO decided, early in the process, to defer consideration of the issue until after the comprehensive cost-allocation framework. Thus, the upcoming "draft final proposal" for FRP cost allocation – one single opportunity for stakeholder comment on the CAISO's rushed proposal – will almost by definition not result in a considered and complete framework that is really ready for final consideration by the Board.

Simultaneous development of the FRP cost-allocation proposal, and the cost-allocation guiding principles that it is supposed to reflect, would not provide sufficient opportunity to carefully examine the application of the latter to the former. As noted in its previous comments on the FRP Straw Proposal, LSA had serious concerns with the CAISO's initial FRP cost-allocation proposal, because the proposed "buckets" and metrics did not necessarily represent an accurate measure of FRP "cost causation."

LSA did not contest the CAISO's proposals in the FRP Revised Straw Proposal to publish these metrics, because the CAISO made it clear that they would not be used to actually allocate costs until after the comprehensive cost-allocation examination. If the CAISO now changes its mind again this late in the process, stakeholders must have the opportunity to provide additional feedback, and the CAISO must seriously consider that feedback.

If the upcoming FRP cost-allocation "draft final proposal" looks like the earlier buckets-and-metrics framework developed before the "guiding principles" were even proposed, and then the CAISO uses those after-the-fact principles to justify the earlier cost-allocation design, then the development of the principles will have been a misleading and empty exercise instead of the thoughtful effort promised. If the FRP proposal is entirely different, there will be inadequate time for stakeholders to consider it or for the CAISO to properly refine it.

In summary, CAISO should return to its prior, wiser course of action and use the Regulation cost-allocation method for FRP, until it conducts and completes the thorough examination of cost-allocation and cost-causation principles that it promised in the RI-MPR2 process.

The proposed principles

The proposed principles represent a good start for a comprehensive examination of cost allocation in CAISO markets. LSA itself recommended some of them in its earlier RI-MPR2 and FRP comments.

However, several of the principles require modification, and other principles should be allocated to the list. These changes will require stakeholder input and debate, and the CAISO should provide those opportunities before rushing to adopt these principles just to accommodate the FRP approval schedule

Specifically, LSA generally supports the following cost-allocation principles in the Proposal:

- **Policy Alignment:** Supports the "economically efficient achievement" of state and federal policy goals, through: (1) CAISO market design and cost allocation of costs; (2) bilateral capacity market incorporation of costs/benefits; and (3) additional CAISO market cost transparency for other policy decisions.
- **Synchronized:** Align allocation cost drivers as closely as possible to the billing determinant(s). For example, if a procurement target is set based upon expected outcomes, the actual outcome in a single settlement interval may not reflect the cost driver. The expected outcome drove the procurement requirement and incurred cost, not the actual outcome.

- **<u>Rational:</u>** Practicality of the proposed approach. Implementation costs/complexity should:
  - Not exceed the benefits that are intended to be achieved by allocating costs (e.g. it would be economically inefficient to mail a check/bill that is less than the cost of postage);
  - Consider other means of achieving the desired outcomes; and
  - Consider the types of available data and other market impacts (e.g., scheduling/metering granularity of different types of resources – import, export, load, and internal generation).

LSA generally supports these proposed principles, but with the additions and caveats stated below.

- **<u>Causation:</u>** Costs should be charged to resources and/or market participants that benefit from and/or drive the costs. This should consider both: (1) how costs are allocated; and (2) how the collected proceeds are distributed back out to the market.

  LSA's earlier comments noted the difficulty of assessing cost impacts of individual VERs, since the CAISO system is operated on an aggregate basis, and individual VERs' impacts may be positive or negative when they are aggregated with other resources. As shown by Steven Stoft at a prior MSC meeting,[1] the variability of load and renewable generation is not additive, such that the joint effect can be disaggregated by a simple rule.

  Thus, this principle should consider whether and how it can be achieved in a fair and accurate manner. Moreover, as noted above, any cost-causation assessment should also consider beneficial impacts, e.g., the reduction in market energy prices caused by rising VER penetration.

- **<u>Comparable Treatment:</u>** Similarly situated resources and/or market participants should receive similar cost allocations. Emphasizes non-discrimination, e.g., avoidance of special treatment for different technologies and/or market participants.

  LSA's earlier comments stated that such an application should include, not only impacts caused by VERs, but also integration and other costs imposed by other resource types, e.g., reserve needs imposed by the "largest single resource" in an area, environmental limitations on resource dispatch, "must-take" requirements, minimum run/down times or ramping limitations (and Bid-Cost Recovery impacts), and special dispatch needs for Multi-Stage Generators.

- **<u>Combination of two principles:</u>** LSA believes that the two principles summarized below – Incentivize Behavior and Manageable – could be combined. Incentives should only be given to parties that can act on them, and parties that can act in response to incentives must be given those incentives to motivate those actions.

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[1] <u>Allocating Ramping Costs</u>, Steven Stoft, presented at September 30th MSC Meeting.

- **Incentivize Behavior:** Provide appropriate incentives such that costs are allocated to market participants that are able to take actions that will lead to lower CAISO market costs "over a reasonable timeframe," considering the impact of other market mechanisms that might incentivize the same behavior (e.g., incentives to reduce deviations from Day Ahead schedules through exposure to real-time prices for those deviations).

- **Manageable:** Allocate costs to market participant consistent with their ability to manage exposure to the allocation, e.g., by minimizing the allocation variability/complexity and maximizing cost-driver transparency. "Allocating unmanageable costs does not provide market participants with the opportunity to minimize the cost drivers the cost allocation is intended to incent."

Finally, LSA recommends that the CAISO add the principles listed below.

- **Implementation coordination:** In addition to aligning CAISO policy with those of the CPUC and other state and federal policy-makers, the CAISO must coordinate the assessment and implementation of cost-allocation changes with those other entities. LSA has major concerns, for example, that the CAISO is moving to implement major changes in transmission and integration cost-allocation policies before they are properly coordinated with the CPUC and other entities with authority over LSE procurement.

  The CPUC's "least-cost, best-fit" (LCBF) procurement-cost assessment currently assumes that transmission costs (and, potentially, integration costs) would be paid by ratepayers. Assessing such costs to generation, without a corresponding revision in CPUC policies, could charge generators twice for the same costs. If the LCBF methodology considers integration costs in the procurement process and then CAISO charges generators separately for FRP and other integration costs, generators would effectively be charged twice for these costs. That is simply not acceptable.

  This is a critical issue, and one of many problems that the CAISO is ignoring in rushing to revise the FRP cost-allocation methodology before adequate consultation and coordination with the CPUC and other oversight entities. Appropriate incentives must reflect the full context of costs and market dynamics if they are to work properly.

  Policy-makers and stakeholders should have an opportunity to carefully consider whether such costs should be assessed against generation at all, and if so, whether that assessment should best occur in the procurement process or in CAISO markets. However, the CAISO's FRP schedule simply does not allow time for that important discussion, or for reasoned, coordinated decision-making.

- **Facilitate long-term bilateral commercial arrangements:** This principle would encompass the impacts on both existing commercial arrangements and the ability of parties to reach such arrangements in the future. Such contracts are needed to provide the long-term revenue certainty necessary for construction and long-term operation of generation resources needed for reliability and policy reasons. The CAISO itself has noted the importance of long-term agreements in laying the foundations for resource adequacy and the proper operation of its shorter-term markets.

The CAISO has often made revisions or accommodations for existing commercial arrangements – most recently in the 2012 GMC revision process, where the rate structure was modified mostly to accommodate a single stakeholder facing an inordinately large impact under its current contractual arrangement. While the CAISO does not and cannot guarantee to maintain current products/services and rate structures into the future, parties to long-term contracts rely on the CAISO's reasoned consideration of the impacts of significant pricing or other market changes on exiting contractual arrangements and commitments.

The CAISO must also consider the impact of imposing unpredictable costs on different kinds of market participants on their ability to commit to future long-term arrangements, and their ability to fulfill those commitments in today's financial markets. It is vitally important that the CAISO not undertake major market changes without full consideration through a robust stakeholder process that develops long-lasting solutions to incent appropriate short- and long-term procurement decisions and market behavior.