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Comments of Northern California Power Agency
2011 CRR Enhancements Issue Paper

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Northern California Power Agency ("NCPA") provides the following comments in response to the ***2011 CRR Enhancements*** issue paper posted by the CAISO on March 4, 2011, and the subsequent stakeholder conference call held on March 11, 2011. The CAISO has proposed several changes to the Congestion Revenues Rights ("CRR") allocation and auction process in its issue paper. NCPA's comments are focused on the following two topics:

1. Revenue Adequacy Issues; and
2. Simplification of the Allocation Process.

Revenue Adequacy Issues

NCPA believes that achieving revenue adequacy in the CRR process should be treated as a high priority issue to ensure that revenue shortfalls, which are socialized to market participants, are kept to a minimum. Therefore, NCPA agrees that it is very important for CAISO to seek improvements to the CRR process to ensure that revenue adequacy is accomplished. Since the CAISO has shown that revenue shortfalls have occurred due to an over allocation of intertie scheduling point CRRs in the annual process, NCPA supports CAISO's proposed methodology to determine the Operational Transfer Capacity ("OTC") breakeven point for each transmission interface that ensures revenue adequacy; but this support is contingent upon retaining at least one allocation tier in the monthly process. Retaining at least one allocation tier of the monthly process will enable Load Serving Entities ("LSE") the opportunity to supplement their CRR portfolio, and obtain CRRs that have been withheld from the annual process, to better align its CRR portfolio with its power supply mix to hedge congestion exposure.

Simplification of the Allocation Process

NCPA believes that the "simplification" of the allocation process as described in CAISO's issue paper is a major policy change, and NCPA does not support all aspects of the proposed restructuring. NCPA opposes complete elimination of the monthly allocation process and Tier 2 of the annual process. In order for NCPA to hedge its congestion risk when its resource portfolio changes from year-to-year NCPA utilizes Tier 2 and 3 in the annual process, and Tiers 1 and 2 in the monthly process to adjust its portfolio. Tiers 2 and 3 in the annual process affords LSEs the opportunity to acquire CRRs to match their current resource portfolio, which then are also made available for selection in the Priority Nomination Process ("PNP") of the following year. This improves a LSEs ability to hedge their congestion risk, especially considering that LSEs resource portfolios will continue to evolve in response to Renewable Portfolio Standards.

In the CAISO proposal it is suggested that a LSE could convert CRRs purchased in the auction to replace those lost in Tiers 2 and 3 of the annual process. In theory, this assumption may be true, but such acquisition includes substantial risk. First, this proposal would expose LSEs to new risk associated with the valuation and bidding of CRRs in the annual auction process. In order for an LSE to acquire the same CRR it likely would have received in the allocation process, the LSE would have to accurately forecast the value of the CRR and bid appropriately. If the LSE does not value the CRR correctly, or is unsuccessful in its bid, the LSE may be unable to acquire the CRR needed to hedge congestion. Even if the LSE is successful in acquiring the desired CRR through the auction process, the LSE will likely be unable to perfectly hedge its congestion risk and will be exposed to the differential between the auction clearing cost and the actual congestion revenues collected. If a LSE over bids for a CRR in the auction, the LSE will be unable to recoup the cost it incurs in the auction by holding the CRR in the day-ahead market.

The ability of a small LSE to tailor its CRR portfolio is very important because a small LSE is less able to diversify its power supply portfolio, as compared to a large LSE (e.g. large investor owned utility), which can mean a small LSE can have a substantially different exposure to congestion cost when compared to the average calculated congestion exposure in a particular Default LAP. The CAISO's proposal in which auction revenues will simply be allocated to LSE's based on their pro-rata share of load in a particular Default LAP provides no guarantee that the auction revenues distributed will provide the LSEs with the same level of protection from day-ahead congestion costs as can be accomplished under the current structure. In the current allocation process NCPA has the ability to hedge its congestion costs without exposing itself to these additional risks.

Overall, NCPA feels that the current CRR process is working well, and does not believe that the existing structure, and associated activities, is overly burdensome. With that said, if the CAISO elects to modify the current process based on the results of this stakeholder process NCPA believes that Tier 2 of the annual process, and at least a single tier in the month process, must be retained to allow LSEs to select CRRs that are specific to their portfolio. Retaining the second tier of the annual process would at least allow LSEs to obtain annual CRRs that can then be converted to PNP CRRs in the following year. This allows for better matching of congestion exposure in conjunction with changes to a LSE's resource portfolio. Retaining at least one tier in the monthly process will allow LSEs to true-up their CRR portfolio when more information about congestion risk becomes available. NCPA expects that improvements in the process used to release capacity at the intertie scheduling points should improve CRR revenue adequacy, and will likely allow for more CRRs to be cleared in Tier 1 of the monthly process.

Constraining any restructuring effort to the elimination of Tier 3 of the annual process and Tier 2 of the monthly process would provide LSEs some ability to tailor their CRR portfolio, and could also provide a means for CAISO to test what efficiencies could be gained by combining a portion of the allocation and auction process. Such could also allow LSEs to see what level of revenues can be produced by increasing the amount of capacity released in the auction process, and to determine whether this level of revenues provides a satisfactory hedge against congestion.