

Comments on Cost Allocation Guiding Principles Straw Proposal

Submitted By	Company or Entity	Date Submitted
Gifford Jung 604-891-6040	Powerex Corp.	Feb. 28, 2012

Powerex appreciates the opportunity to provide these comments on the Cost Allocation Guiding Principles Straw Proposal (“Straw Proposal”) published on February 14, 2012. Powerex supports the CAISO’s efforts in establishing a set of guiding principles for allocating ISO market costs among market participants.

The Straw Proposal suggests a list of proposed guiding principles:

- Causation;
- Comparable Treatment;
- Policy Alignment;
- Incentivize Behavior;
- Manageable;
- Synchronized; and
- Rational.

Causation

As Powerex has stated in previous stakeholder initiatives, Powerex believes that the primary principle that should guide the CAISO in the allocation of market costs should be cost causation.

Allocation of market costs that do not follow cost causation can result in unintended consequences. If the costs incurred by the CAISO are driven in part by a certain set of market participants or market activity, but those costs are allocated to a (wholly or partially) different set of market participants or activity, the misalignment of costs with benefits will result in skewed energy market prices. Additionally, participants and activity that is not associated with the underlying costs incurred by CAISO will be improperly cross-subsidizing those participants or activities that are not. A cause-based allocation of costs is the critical starting point without which the guiding principle of “incentivizing behavior” cannot be achieved.

Comparable Treatment

As stated in other stakeholder initiatives, Powerex believes that all similarly situated resources should be treated equally within the tariff and Powerex believes that treatment should extend to allocation of costs.

Policy Alignment

The CAISO is regulated by the Federal Energy Regulatory Commission (“FERC”) and Powerex believes the only policies that need to be considered by the CAISO in their cost allocation guiding principles are those policies required by FERC.

Powerex does not agree that Policy Alignment with other “state and federal policy objectives” is an appropriate guiding principle. The pursuit of “state and federal policy objectives” is properly left to those state and federal agencies that develop them. Instead, Powerex believes the CAISO should focus on tariff designs and operations that lead to as efficient and transparent a market as possible.

A CAISO market design that leads to an efficient and transparent market will allow those other state and federal jurisdictions to properly consider the cost implications of their policy objectives.

Incentivize Behavior

Powerex agrees with the CAISO that proper cost allocation based on cost causation principles will provide the appropriate incentives for market participants and lead to economically efficient outcomes. The extent to which this objective is achieved depends critically on the quality of the price signal that market participants face for different types of activity. Therefore, Powerex believes that “Cost Causation” and “Incentivize Behavior” objectives are paramount among the guidelines proposed by the CAISO.

Manageable

Powerex agrees that the CAISO “market design should seek to minimize variability and complexity of the allocation and maximize the transparency of cost drivers.” Furthermore, Powerex believes that the CAISO should retain its two-tier cost allocation to ensure costs are never allocated in an unjust or unmanageable manner.

Synchronized

Powerex agrees that “[t]he cost drivers of the allocation should align as closely as possible to the selected billing determinant.” Similar to Powerex’s comments above, an appropriate use of two-tier cost allocation is when procurement requirements are set on expected outcomes and costs are allocated on actual outcomes.

Rational

Powerex believes this guiding principle is inappropriate. If the other guiding principles strongly point to a particular cost allocation approach, the CAISO should implement that cost allocation. Delaying the change in cost allocation will only lead to an inefficient market design and higher costs. Inevitably, the CAISO will need to re-visit the market design and cost allocation at a later date as costs escalate and other unintended consequences become apparent. Additionally, persistent inequities lead to entrenched stakeholder positions as constituencies are created that would stand to lose under a revised allocation. The longer the change is delayed, the more difficult change will be to implement.

This proposed principle also suffers from the difficulty in measuring the “benefits” as well as the more easily-measured “costs” of implementation. The benefits include not only the total dollars to be allocated differently, but the improved behavior of the activities or participants subject to the improved incentives. Powerex is greatly concerned that this guiding principle, if adopted, could be used to avoid beneficial and appropriate improvements simply due to difficulty in quantifying the benefits.