Stakeholder Comments on 2011 CRR Enhancements

Submitted by	Company	Date Submitted
Ken Kohtz: 408-615-6676	*City of Santa Clara, dba Silicon Valley Power (SVP)*	*March 18, 2011*

Background & Comments Summary

Silicon Valley Power (SVP) appreciates the opportunity to provide 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 under the scope of 2011 CRR enhancement. SVP's comments are focused on two topics:

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

SVP agrees with the CAISO that revenue adequacy is an important issue that needs to be addressed in coordination with stakeholders. SVP **could support** the proposed methodology to determine the Operational Transfer Capacity "OTC" breakeven point for each transmission interface of the ISO market that ensures revenue adequacy for the annual process, but only if the monthly allocation process is continued to allow Load Serving Entities (LSE) the opportunity to obtain CRRs that have been withheld from the annual process. SVP also submits that the CAISO should explicitly describe the OTC breakeven methodology in its tariff, and would recommend that the CAISO provide stakeholders the opportunity to review and comment upon such language before the CAISO files it at FERC.

SVP believes that the so-called "simplification" of the Allocation Process is a major policy change and does not merely constitute a procedural adjustment. The CAISO proposal is fraught with issues that place LSEs at a considerable disadvantage in hedging their risk relative to the existing CRR allocation process. We **strongly oppose** implementing the proposed simplification of the Allocation Process on the following grounds: (1) as the CAISO has acknowledged, there is little-to-no support among market participants for such a major shift in the CRR allocation/auction process; (2) expanding the annual and monthly auction processes reduces the opportunity for LSEs to obtain allocated CRRs that meet their hedging needs; (3) the CAISO proposal ignores the fact that actual congestion exposure can be quite different from the congestion exposure expected at the time of the auction; (4) the proposal fails to demonstrate a significant reduction in administrative costs or a significant enhancement in market efficiency to justify changing a process that is working well; (5) the CAISO likely will face several contentious issues, such as the transfer of CRRs auctioned in a given year to the next year's Priority Nomination Process (PNP) for LSEs, which would create discontinuity between market value for LSE vs. non-LSE auction participants; and (6) elimination of the monthly CRR allocation process removes the opportunity for LSEs to obtain their desired congestion hedge with the benefit of much better, and time-specific, information about actual conditions than is available in the annual process.

Revenue Adequacy Issues

Conflict between Implementing Breakeven OTC in Annual Process and Eliminating the Monthly Allocation Process

There is an important linkage between the annual and monthly allocation processes that should not be disrupted, as it would be if the monthly allocation process were eliminated. Implementation of breakeven OTC methodology on the inter-ties will lead to a relatively lower amount of annual CRR allocations from the Scheduling Points (SP). This change would be acceptable to LSEs only if they would have every opportunity to obtain these SP CRRs in the monthly allocation process. However, the elimination of the monthly allocation process would deny the LSEs any such opportunity. The approach proposed by the CAISO of distributing the monthly auction proceeds on a load proportionate basis would not allow the LSEs to obtain specific desired SP CRRs or receive their corresponding value.

Distinguish Between Annual and Monthly OTC Treatment

SVP appreciates the importance of the revenue inadequacy issue the CAISO has faced since the implementation of MRTU. SVP understands that the main source for revenue deficiency is the release of too many CRRs in the annual allocation process. SVP believes that proposed OTC methodology would be superior to the current approach, which is based on the application of an arbitrary Global Derate Factor (GDF) in the monthly CRR allocation and auction process.

We understand that the proposal is to apply the "breakeven OTC" methodology in the annual allocation process only. SVP supports such a change to the annual allocation process, but only if the monthly allocation process is retained. Although not in the current proposal, SVP would oppose extending the OTC breakeven point method to determine monthly OTC value for two main reasons. First, in the monthly process, the CAISO has better information regarding planned outages, and such information may impact the OTC associated with a particular inter-tie. SVP submits that this information should be used in adjusting capacity values, rather than relying on historical outage data that includes both planned and unplanned outages. If historical data is to be used in conjunction with planned outage information, then only estimated unplanned outages should be included in the historical data set to avoid the double-counting of outages. Second, if a monthly OTC adjustment is applied, then the CAISO should not also apply GDFs in the monthly process. We believe that the proposed OTC methodology, if applied to the monthly process, could result in unnecessarily restrictive OTC amounts at the inter-ties that could severely limit the ability of market participants to obtain CRRs from the inter-ties even though adequate inter-tie capacity is available.

Simplification of the Allocation Process

If it ain't Broke, Don't Fix it

During the stakeholder conference call on March 11th, the CAISO staff acknowledged that the proposed allocation process "simplification" was not requested by market participants. The CAISO is only three years into a process that took a significant amount of time and effort to develop and implement. SVP submits that the proposed "simplification" invariably would result in unforeseen difficulties that would require additional resources, and further submits that it is too soon to be proposing such a major change.

In terms of cost versus benefit of implementing such a change, the CAISO has stated that costs could be avoided by merging allocation tiers; however, the CAISO has yet to quantify these costs. The CRR allocation tiers that the CAISO is proposing to eliminate have enabled SVP, and likely other CRR Entities, to obtain additional CRRs that are important for meeting internal hedging strategies.

CAISO Proposed "Simplification" will have a Disproportionate Impact on Some Market Participants

The CAISO proposal improperly treats all LSEs in a given area as if they had the same hedging strategy. Reductions in the amount of CRRs available for allocations reduce an LSE's ability to hedge actual congestion exposure. The CAISO's current proposal to distribute the auction proceeds based on the *ISO-NE* method takes into consideration the sink congestion (differences in congestion exposure based on where the load is located), but totally disregards the source congestion, from where most of the congestion exposure is derived. In other words, the CAISO's proposed method of distributing the auction proceeds to LSEs does not ensure that LSEs receive benefits correlated to their actual congestion exposure.[1]

To remedy this asymmetrical treatment among market participants via the CRR auction mechanism, the CAISO would need to adopt PJM's or MISO's Auction Revenue Rights (ARR) approach in order to hedge the particular source-sink (path) congestion. But the CAISO is proposing the *ISO-NE* approach for administrative simplicity. While the PJM/MISO ARR approach would not reduce any "administrative burden" associated with running the allocation

[1] Consider a simple example with two LSEs located in the same LAP. *LSE A* is a small LSE, which routinely schedules deliveries on inter-tie X. On the other hand, *LSE B* has a larger base load and schedules exclusively from generation sources located near its load. *LSE A* does not have an adequate amount of CRRs from the inter-tie X in its PNT and Tier LT to cover its congestion exposure in the Day-Ahead Market (DAM). Also assume that the congestion exposure (and therefore the CRR value in auction as well as in the DAM) from X to the LAP is significantly higher than the corresponding value from generators located in the same LAP as the load. In the current CRR allocation process, *LSE A* has the opportunity to procure additional CRRs from Tier 2 and Tier 3 in the annual process as well as from Tier 1 and Tier 2 in the monthly allocation process to hedge *LSE A*'s actual congestion exposure. Under the CAISO proposal, *LSE A* will have no comparable ability to hedge its DAM congestion, except to purchase inter-tie CRRs in the auction. But the load-based pro-rata share of the annual and monthly auction proceeds will be inadequate in compensating the smaller *LSE A* for these lost opportunities. On the other hand, *LSE B*, with a much larger load (and with no deliveries from inter-tie X,) will get a proportionately higher share of auction proceeds (which includes auction revenues from inter-tie CRRs sinking into the LAP).

process, it would be necessary to adopt this approach to enable LSE's to meet their hedging needs. Therefore, SVP submits that there is no need to change the current allocation processes at this time. To be consistent with past practices, the CAISO is proposing to allow LSEs to nominate any CRRs received in the new combined Tier 2, Tier 3 and auction process in the next year's PNP. SVP believes that this proposal has a major flaw in that it does not distinguish between LSE and non-LSE interests. An LSE will have more value at stake in the annual auction process, as it can potentially convert the received-from-auction CRR into the next year's PNP and then potentially into Tier LT. However, a non-LSE does not have such an incentive and its interests are limited to that specific year. We believe that the CAISO will come across several such issues under the "simplification" proposal that would be inconsistent with the fundamental principle of offering LSEs a reasonable opportunity to hedge their congestion.

Monthly Allocation Process is Critically Important

Finally, the monthly allocation process is an important mechanism for LSEs to obtain CRRs with the benefit of much better information about actual conditions. LSEs would be significantly worse off if their ability to hedge their actual congestion via CRRs allocated in the monthly process are removed. SVP does not believe that the monthly CRR auction process offers any equivalent opportunity to compensate for those losses.[2]

[2] LSEs would need to purchase the required CRRs in the monthly auction under the proposed simplification, but would receive only a proportionate share of the auction proceeds, which would not necessarily offset the LSE's auction purchase costs.