Stakeholder Comments Template

Subject: Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch

Submitted by	Company	Date Submitted
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This template was created to help stakeholders structure their written comments on topics related to the July 15, 2010 Straw Proposal for Capacity Procurement Mechanism ("CPM"), and Compensation and Bid Mitigation for Exceptional Dispatch. Please submit comments (in MS Word) to bmcallister@caiso.com no later than the close of business on July 30, 2010.

Please add your comments where indicated responding to the topic or question raised. Your comments on any aspect of the straw proposal are welcome. The comments received will assist the ISO with the development of the Draft Final Proposal.

Please provide your comments on the following topics and questions. Your comments will be most useful if you provide the reasons and the business case for your preferred approaches to these topics.

CPM

1. The appropriate duration of the tariff provisions associated with the CPM: should they be permanent or terminate on a certain date or under certain conditions? If the CPM should terminate, please be specific about the date or conditions upon which it would terminate and indicate the reasons for your proposal.

   WPTF agrees that a permanent structure is acceptable so long there is a periodic (e.g., 2 year) review and mechanisms to adjust pricing if such pricing is based on market conditions.

2. The appropriate treatment of resources that may be procured through CPM or Exceptional Dispatch but then go out on Planned Outage during the period for which the resource has been procured. What are your views on the proposed formula in the straw proposal for compensating such resources?

The CAISO proposal seems reasonable.

3. Modification of the criteria for choosing a resource to procure under CPM (section 43.3) to provide the ISO with the ability to procure non-use limited capacity over use-limited capacity.

   The expansion of the criteria to recommend resource use limitations needs further review, because nearly all resources have physical or economic use limits. Therefore, the CAISO's proposal to establish criteria for procurement based on use limitations will require more extensive vetting. Vetting is needed to ensure that there is adequate transparency with respect to the selection criteria and that such additional procurement criteria are needed in addition to the planning reserve margin that is already included in the RA program. If expansion is found to be necessary, the optimal approach would be to define the market algorithms to recognize the CAISO's needs and the resource constraints such that resources can be procured in the most efficient manner and their selection can be priced in accordance with the value they offer. Moreover, it will be important that the CAISO requirements are fully reflected in the RA program requirements, so as to minimize the need for CAISO procurement of RA resources. In summary, WPTF requests additional information on this particular recommendation such that parties can understand what the issues are that have led the CAISO to believe that such selection criteria are needed. Following receipt of such information WPTF would be pleased to refine its response.

4. The three new types of procurement authority for generic backstop capacity the ISO is proposing.

   <u>Procurement for planned maintenance</u>: It is unclear why the CAISO needs to procure under a CPM for planned maintenance, when the planning reserve margin that is imposed on all jurisdictional LSEs already provides for capacity to cover contingencies. In other words, RA procurement should be sufficient to account for outages. If the CAISO is finding itself short of capacity due to outage than the RA requirements need to be revised. WPTF would like further details regarding what needs the CAISO has experienced that are not provided through RA that requires backstop procurement authority.

   <u>Procurement for less than planned output from intermittent resources</u>: If the CAISO is finding itself left with insufficient resources due to failure of certain resources to deliver then either (1) the counting rules for intermittents need further refinement or (2) the intermittent resource failing to deliver should be replacing its RA. In any event, procuring through CPM because a specific category of resources is assigned a higher RA component than it is capable of delivering should be resolved by correcting the counting rules in the RA program rather than triggering generic backstop procurement by the CAISO. WPTF recognizes that the CAISO has the ultimate responsibility for meeting applicable

reliability, and having this backstop procurement authority is consistent with that responsibility. However, the CAISO should fix the root cause of this problem or provide more information about why that is not possible to do so.

Procurement from resources that are in danger of shutting down: Backstop procurement of resources "that are in danger of shutting down" indicates inadequacies in the RA system and/or the planning reserve margin that should be addressed with fundamental reforms to the energy markets on an expedited basis. Economic principles dictate that resources will not remain in the market if revenues are insufficient to cover a unit's costs, plus a profit. Until such fundamental reforms are made, the ISO must have the flexibility to designate units necessary for grid reliability to the extent that the existing planning reserve margin does not already provide sufficient backstop, and must be able to compensate such units under its backstop procurement authority.

Going forward, however, the CAISO must recognize that if units that the CAISO consider critical to reliability are "in danger of shutting down", then the ISO has an independent legal obligation to institute market reforms that provide such units market incentives to stay available. As part of this fundamental reform effort, the CAISO should encourage the CPUC to adopt RA program criteria that will minimize the need for need for backstop procurement by the CAISO.

5. The compensation that should be paid for generic capacity procured under CPM and Exceptional Dispatch. Which method do you support: Option A – CONE net of peak energy rent; or Option B – going forward costs? Are there further modifications needed to either of these pricing options? If you have a specific alternative pricing proposal, please provide it and indicate the reasons for your proposal.

WPTF supports using net CONE as the basis for compensating capacity procured under CPM and Exceptional Dispatch but has concerns about the use of a demand curve as proposed by the CAISO.

If the CAISO has capacity services that it procures that have not been met by the RA program, then it must procure these capacity products based on the alternative replacement cost. If the CAISO continues to procure based on going forward costs it will cause continued market distortions and provide disincentives to the provision of these services through RA contracting or IFM solutions. It is imperative that the CAISO's backstop procurement reflect all-in costs. The business case for such pricing should be very evident. The 2009 DMM report is clear that energy and AS revenues are not sufficient to incent investment. Absent improvements to the price signals from energy and AS, capacity prices become the vehicle for ensuring that the market is providing revenues that will incent investment; CAISO procurement of capacity that is not met by the RA program must be structured to pay a CONE-type price or else its procurement authority will create significant market distortions.

With respect to the CAISO CONE proposal, WPTF has concerns about the demand-curve characteristics embedded in that proposal as it is unnecessarily complex and ill suited for backstop capacity procurement. In particular the proposed downward sloping curve presumes sufficient RA resources. When the CPM is triggered then - by definition - there is insufficient capacity. This may be due to a failure of the RA mechanism to reflect certain needs (e.g., contingencies), but the CPM should not exacerbate the RA deficiencies by presuming that there is no shortage when RA is otherwise fully sourced. Rather the CPM should reflect the service that is needed by the CAISO that is not being priced through RA or the IFM. Only by doing this will a sufficient feedback loop to the RA program, IFM design, and forward contracting be created such that the ISO and bilateral markets move toward including these needed services. Failure to compensate in this manner will continue to distort procurement and investment.

Finally with respect to the interaction of the ISO and PUC rules and pricing, WPTF acknowledges that if the PUC's waiver price is different than the CPM pricing, there is the potential for market distortions, because both mechanisms serve to establish the framework for market pricing. However, the CAISO must establish a backstop pricing framework that reasonably recognizes the value of capacity required to meet reliability criteria. Ideally, the two backstop procurement price and the waiver threshold price should be the same. Nevertheless, in this stakeholder effort, it is important that the CAISO work to establish an appropriate backstop procurement price that is consistent with competitive market formation, and the CAISO's ultimate responsibility to assure reliable operations.

6. The need for the ISO to procure non-generic capacity under CPM and Exceptional Dispatch to meet operational needs.

   Using CPM for new operational needs such as ramping is a slippery slope and WPTF advises against CPM being seen as a solution for operational needs. Using CPM would mask the needs and prevent the development of new market products and services to meet those needs, and it would prevent proper cost allocation. If the CAISO anticipates needs in the near term that cannot yet be fulfilled through established, transparent, markets, then such needs should be articulated first. Then stakeholders can comment on the appropriate solution given those specific operational needs.

7. The operational criteria the ISO is proposing to distinguish certain operational characteristics as non-generic capacity (fast ramping and load following). Are these two characteristics enough, or do you propose additional criteria for operating characteristics that would qualify for non-generic capacity?

   See response to # 6 above.

8. How should non-generic capacity be compensated? What are your views on the proposal to compensate non-generic capacity by applying an adder to the price paid for generic capacity?

   See response to #6 above. However, in short, the service should be compensated based on the incremental cost to fulfill the service. If the service is a capacity-based service then compensation should be based on the replacement value including the cost of the unique service warranted. For example, if the CAISO needs fast ramping, prices have to reflect the cost of building fast ramping resources. Only through such pricing will incentives be provided for resources to create fast-ramp capabilities. If compensation does not distinguish between services then investors will not provide what is needed.

Exceptional Dispatch

1. Should energy bids for resources dispatched under Exceptional Dispatch continue to be mitigated under certain circumstances? Should such mitigation continue the current practices of bid mitigation as outlined in the straw proposal?

   The CAISO needs to protect against market power when a party has the demonstrated ability to exercise market power. But the mitigation under ED must change. The CAISO's July white paper can be viewed as mischaracterizing the situation. It states:

   > **Dispatches to Mitigate Congestion on Non-Competitive Paths.** A non-competitive transmission path is defined as a path for which one or more market participants have the ability to exercise market power. As such, market participants clearly have the potential to exercise market power in the case of Exceptional Dispatches to relieve congestion on non-competitive transmission paths and mitigation is appropriate.

   In fact, the CAISO is currently mitigating EDs with much evidence (based on the competitive path assessment findings) that such resources *do not* have market power. This distorts the LMPs and can under-compensate generation owners. The CAISO need not and should not put ED mitigation reform on hold while DMM addresses Competitive Path Assessment deficiencies. Rather the CAISO has an obligation imposed by FERC to remedy any deficiencies with ICPM now. Simply because DMM's preference is to fix aspects later, that does not excuse the CAISO from addressing FERC requirement with respect to ICPM.

   The CAISO has indicated that it has no evidence that market participants are attempting to exercise market power. As a result there is neither theoretical nor empirical evidence to support continued mitigation of resources based on the past CPA. (See WPTF's July 07, 2010 filing to FERC on the ISO's CPA for a full discussion of these issues.)

2. Should the ISO change the categories of bids subject to mitigation under Exceptional Dispatch (Targeted, Limited and FERC Approved) and extend the bid mitigation for the existing categories?

   See response to #1 above.

3. What is the appropriate compensation for non-RA, non-RMR and non-CPM capacity that is Exceptionally Dispatched? Should the current compensation methodology be extended, updated to agree with what is put in place for CPM for generic capacity procurement?

   Quite simply, resources exceptionally dispatched for energy should drive, and receive, marginal energy prices. Resources exceptionally dispatched for other services should be paid the marginal value of those other services. As such resources exceptionally dispatched for capacity services should be paid a CONE-type price.

<u>Other</u>

1. Do you have any additional comments that you would like to provide?

   Yes. WPTF would like to clarify that WPTF is composed of members that are both buyers and sellers of capacity, and sometimes have business on both the buying and selling end. As such, WPTF members recognize the appropriateness of transparency and market-based mechanisms and pricing. The current set of products at the CAISO does not sufficiently support investment decisions, and the prices do not reflect CAISO needs. WPTF members are opposed to energy prices that do not reflect dispatch costs, especially where certain costs, such as out-of-market dispatches, are included in uplifts instead of reflected in the LMP. WPTF believes that uplifts mask the true marginal cost of the products and services procured by the CAISO, and since the uplifts cannot be avoided by buyers, buyers cannot hedge their exposure to these additional costs through the bilateral market place. WPTF offers this review of its balanced membership as a prelude to a reminder that appropriate resolutions to CPM and ED issues should not be developed based on how the issues are viewed from strictly a buyer-versus-seller perspective, but rather based on solutions that further the development of competitive markets that support needed investment in existing and new resources.[1]

[1] For example in its July 15, 2010 white paper the CAISO indicated that: "In their comments, stakeholders were largely split between these options, depending on whether they were buyers or sellers of capacity…

Calpine, JP Morgan, RRI Energy and Mirant, and WPTF suggest either basing compensation on the cost of new entry or re-visiting the issue to ensure generators are fairly paid for the service they offer. NCPA, SCE, PG&E and Six Cities all argue to continue the going-forward methodology." (Page 10).