California ISO
Your Link to Power

California Independent
System Operator Corporation

Memorandum

To: ISO Board of Governors

From: Udi Helman, Principal Market Economist

Anjali Sheffrin, Chief Economist / Director, Market and Product Development

Date: May 13, 2008

Re: ***Decision on Exceptional Dispatch***

This memorandum requires Board action.

EXECUTIVE SUMMARY

Under the Market Redesign and Technology Upgrade (MRTU) Tariff, an Exceptional Dispatch is a commitment or dispatch directed by grid operators that is not determined through the market software. These are manual instructions to generators (or participating loads) to start-up, shut-down, provide incremental energy, or provide decremental energy.[1] Typically, an Exceptional Dispatch is required to address a transmission constraint or generation unit operating constraint that was not captured in the models used in the Integrated Forward Market (IFM), the Reliability Unit Commitment (RUC) or the Real-Time Market (RTM), and may be needed to avoid a system emergency.[2] During the recent months, pricing for Exceptional Dispatch has been the subject of two stakeholder processes. The first, concluded in January 2008, examined the market power of generators subject to Exceptional Dispatch, and resulted in a proposal by the CAISO Department of Market Monitoring (DMM) to modify the current MRTU tariff provisions to mitigate Bids for certain Exceptional Dispatches. The second, begun in March of this year, examined options for altering or augmenting the mitigation rules such that certain suppliers subject to mitigation could collect additional revenues and resulted in the pricing proposal described in this memorandum. Management determined to combine these two efforts into one proposal to the Board.

In brief, under the combined proposal, Management proposes to apply mitigation to all Bids of units subject to Exceptional Dispatches in specified situations that could result in locational market power and would not apply for competitive system conditions. However, some stakeholders have concerns that the Bid mitigation may leave certain units only covering their short-term variable costs and a subset of these resources may not have other sources of revenues towards coverage of fixed costs, such as Resource Adequacy (RA) contracts, Reliability Must Run (RMR) Contracts or an Interim Capacity Pricing Mechanism (ICPM) designation. Recognizing such units may

[1] Resources with Participating Generator Agreements (PGAs) or Participating Load Agreements have an obligation to comply with Exceptional Dispatch. Resources under a Metered Sub-System Agreement (MSSA) only have this obligation during an emergency. Other resources do not have an obligation.

[2] Section 34.9 of the MRTU tariff sets forth the CAISO's authority to issue Exceptional Dispatches. Not all Exceptional Dispatches are to avoid a system emergency. Other reasons for Exceptional Dispatch include pre-commercial testing and Ancillary Services testing.

be needed to prevent or respond to System Emergencies, Management proposes to allow such resources to obtain some level of fixed cost recovery when they are subject to Bid mitigation. Specifically, such resources will be eligible for a "relaxed" mitigation rule that allows payment of up to their *unmitigated* market Bid until revenues reach a revenue cap that is equivalent to a monthly ICPM payment towards fixed cost recovery. Once the revenue cap is reached, the resource's Bids will be subject to mitigation for the remainder of the month. Note that resources will always keep any revenues earned from LMPs at their locations; this "relaxed" mitigation rule allows them to augment the market revenues that they would have otherwise earned while subject to mitigation. Finally, this proposal has a staged implementation. As noted, Exceptional Dispatches of primary concern to management are those that result from operating constraints that are not fully reflected in the network models underlying the MRTU markets. Management thus recommends that during the initial two months of MRTU, the CAISO use a more restrictive approach to providing supplemental payments to eligible resources, such that their Bids subject to mitigation will be augmented with a $24/MWh Bid Adder which would allow supplemental revenues to accrue at a slower rate. After this initial two-month time period, the "relaxed" mitigation will be implemented. This phased approach will allow the CAISO to learn from actual market operations and to enhance the market models to minimize the need for Exceptional Dispatch. While the CAISO is committed to addressing modeling issues prior to start up, it is very likely that additional issues will arise during the start-up of MRTU. A two-month "grace period" will serve as a safeguard against extraordinary costs in the event of frequent Exceptional Dispatches during the initial two months of operations.

MOTION

Moved, that the ISO Board of Governors approves the proposal for market power mitigation and revised pricing of Exceptional Dispatch as described in the memorandum dated May 13, 2008, and related attachments; and

Moved, that the ISO Board of Governors authorizes Management to make all the necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposal for market power mitigation and revised pricing of Exceptional Dispatch.

ISSUE STATEMENT

(a) Proposed Market Power Mitigation Rules for Exceptional Dispatch

As noted, the first phase of the stakeholder process focused on devising mitigation rules for Exceptional Dispatch Bids. When the MRTU Tariff was being developed, the MRTU software was still in development and it was expected that Exceptional Dispatch would be an infrequent and typically unpredictable event. Therefore, the Tariff allows that resources subject to Exceptional Dispatch would be paid the higher of their submitted Bid into the daily markets or the LMP, or if they had not submitted a Bid, the higher of their Default Energy Bid (DEB) or the LMP. However, issues associated with the potential for exerting locational market power, that is, when suppliers would anticipate that their Bids would be subject to Exceptional Dispatch, and, therefore, submit extremely high Bids, became evident in stakeholder discussions over the proposed pricing rules for the ICPM that took place in late 2007. [3] One issue raised during these discussions was whether non-RA resources receiving a high (unmitigated)

[3] The ICPM is CAISO's proposed mechanism for procurement of backstop capacity from resources that do not already have an RA or RMR contract under MRTU. ICPM procurement will take place in two timeframes: the Type 1 procurement will backstop the forward (bilateral) RA market; Type 2 procurement will be in response to Significant Events that are enduring, such as major generation or transmission outages, that take place in real-time operations and do not allow for all reliability criteria to be met with the available RA resources. CAISO has proposed the same ICPM price for both types of procurements: the higher of $41/kW-year or a $/kW-year rate based on a unit's actual going forward costs as filed at FERC. The final ICPM price and designation rule has yet to be determined by FERC. The ICPM proposal as filed allows a generator to choose whether to accept designation. The expectation is that the price offer for

Bid offer price through Exceptional Dispatch would voluntarily accept an ICPM designation. Those discussions, and further inquiries into the capabilities of the MRTU software, especially upon market start-up, prompted a re-examination of the market power that could be exerted by resources subject to Exceptional Dispatch in some circumstances. This instigated the stakeholder process and market power mitigation proposal by the DMM.[4] The mitigation proposal was presented on an informational basis to the Board at the January 2008 meeting.

Upon review, and consideration of the uncertainty about the frequency and predictability of Exceptional Dispatch, the CAISO has determined to retain the proposed mitigation rules, which are briefly summarized here, but also to augment them as discussed in the next section. Specifically, units subject to mitigation would receive the higher of:

- The unit's Default Energy Bid (DEB) , or
- The LMP at their location.

The mitigation rule would apply to Exceptional Dispatches for energy needed for:

- Reliability requirements related to non-competitive transmission constraints;[5]
- Ramping units up from minimum operating levels to minimum dispatchable levels in order to protect against reliability contingencies that are not directly incorporated or sufficiently met by the MRTU software; and
- Other special unit-specific operating or environmental constraints not incorporated in the MRTU model.[6]

Consistent with the rules for mitigation of market offers, the mitigation rule would not apply to Exceptional Dispatches for energy needed for:

- System-wide energy requirements; and
- Relief of congestion on competitive transmission constraints.

As explained by DMM, the above categories for application of mitigation were developed based in part on input from CAISO Operations staff on the potential reasons that Exceptional Dispatches may be issued under MRTU, and the ability of CAISO Operators to identify and log the reason for Exceptional Dispatches into various categories.[7] The mitigation of generators that are identified as having market power on non-competitive transmission constraints is consistent with the market treatment of such Bids through the automated Market Power Mitigation process. The other two situations were identified as ones in which particular generators would have knowledge that due to unit operating constraints not represented in the IFM, they would likely be Exceptionally Dispatched subsequent to the Day-Ahead Schedule, thus allowing the supplier to raise its Bid accordingly.

Under the proposed rules, generators would always be paid the higher of LMPs or the mitigated Bid. Hence, in principle, no supplier should receive less than its short-term variable costs of operation and may receive higher than that. Exceptional Dispatch to support reliability could occur during many different market and system conditions. In some circumstances, such as outages or deratings of large generators or transmission facilities, LMPs should be high enough to provide appropriate market compensation to most generators subject to Exceptional Dispatch even with mitigation. CAISO will also be introducing scarcity pricing within one year of MRTU start-up, which may further increase LMPs above the offers of marginal units at those times when most units are likely to be committed.

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designation will be sufficient that any generator will accept the offer voluntarily. The filed proposal can be found at http://www.caiso.com/1bc5/1bc5db284cc80.html.

[4] This process included several papers and several stakeholder conference calls to discuss the DMM mitigation proposal for Exceptional Dispatch. These documents can be found at http://www.caiso.com/1c89/1c89d76950e00.html

[5] DMM presentation on Competitive Path Assessment can be found at: http://www.caiso.com/1f52/1f52bd74746f0.pdf

[6] Certain Exceptional Dispatches will not be eligible for bid-based compensation, e.g. pre-commercial testing and Ancillary Services testing. Any such Exceptional Dispatches will get the higher of the LMP or DEB.

(b) Rationale for Supplemental Payments to Augment Proposed Mitigation Rules

While Load Serving Entity stakeholders supported the mitigation proposal, most generator stakeholders raised concerns about whether CAISO's ability to call on resources through Exceptional Dispatch while mitigating their Bids to variable costs would suppress forward RA prices and affect RA procurement incentives, encourage excessive CAISO use of such dispatch, and leave certain infrequently operated generators unable to recover annual fixed costs, especially generators without capacity contracts. As noted, Exceptional Dispatch is expected to be an infrequent measure and as such is unlikely to have significant impacts on market prices or the revenues of specific generators. However, in response to generator stakeholder concerns, CAISO initiated a further stakeholder process to examine whether, if Exceptional Dispatch Bids are mitigated, modifications to the mitigation or other pricing rules were appropriate to compensate for some effects on prices and revenues, notably to provide a mechanism for contribution to fixed cost recovery. Fixed costs are recovered both through energy and ancillary service market revenues (forward and spot), when a generator earns more than its variable costs, and through capacity payments, such as through RA contracts or ICPM designations (or through a an RMR contract that uses an expectation of future market revenues when establishing the contract price to cover a unit's annual fixed revenue requirements).

CAISO did agree with certain stakeholders that the combination of mitigation and Exceptional Dispatch would at times suppress spot market revenues. The incremental energy from Exceptional Dispatch, which is settled financially out-of-market, will be considered in the real-time market as effectively zero price energy, thus lowering the LMP. In general, resources with types of capacity contracts – RA, RMR or ICPM – have a guaranteed contribution to fixed cost recovery and should be less susceptible to the market revenue impact of infrequent Exceptional Dispatches. For the remaining resources on the Grid without any such capacity contracts, mitigation to short-term variable cost could indeed affect recovery of fixed costs for individual plants (although not necessarily for the portfolio of plants owned by a firm). To compensate for this type of situation when Bids *are* cleared through the markets, there is a Bid Adder of $24/MWh for Frequently Mitigated Units (FMU) that have no or partial unit RA or ICPM contracts. This adder can set the LMP. Also, units without RA or ICPM contracts can submit Bids up to $250/MWh in the RUC for their capacity. Thus, an additional opportunity to earn revenues towards fixed cost recovery is reasonable in out-of-market dispatches where mitigated Bids may only cover variable costs for resources without capacity contracts and also to reflect the reliability benefits offered by such resources. There was substantial stakeholder acceptance of this point, and the second phase of the stakeholder process was primarily focused on examining supplementary pricing options, such as a Bid Adder or capacity payment or other mechanism. These are discussed in the next section.

It is worth noting that CAISO has filed at FERC for a backstop capacity payment triggered by real-time reliability events, under ICPM, as a mechanism for providing a contribution to non-RA units towards recovery of going forward fixed costs. An ICPM designation, as filed with FERC, is for a minimum of one month and requires the designated resource to offer into the MRTU markets for the period of designation. In some circumstances, a transmission or generation outage or some other event may require CAISO to start-up or redispatch non-RA units through Exceptional Dispatch and if the situation is considered an enduring Significant Event (a defined term under ICPM), the CAISO may also subsequently offer them an ICPM designation. However, many Exceptional Dispatches will not be correlated with enduring Significant Events but will rather be occasional manual actions by the grid operators. Hence, while some suppliers have argued both in this stakeholder process and in the ICPM proceeding currently before FERC that *any* Exceptional Dispatch of a non-RA unit should lead to an ICPM designation, CAISO has not agreed with that view. However, as discussed below, CAISO has proposed that the ICPM monthly payment should be a cap on the supplemental revenues accruing under Exceptional Dispatch, in recognition that the ICPM payment, as approved by FERC, can be considered a reasonable contribution towards fixed costs. Moreover, as noted, even when subject to mitigation, a resource under Exceptional Dispatch will never be prevented from retaining the market revenues at its location during the period of Exceptional Dispatch.

A few other issues were raised in the second phase of the stakeholder process related to the mitigation. Notably, some stakeholders argued that the DEB does not adequately provide mechanisms for recovery of certain types of short-term variable costs that might accrue under Exceptional Dispatch. For example, Reliant is concerned about recovery of "intra-day gas costs, which consist of LDC scheduling imbalance charges, firm access rights costs and gas costs for that day." Reliant requests that if mitigation is imposed, the CAISO accept additional information ex post on such costs to supplement the DEB calculation. Reliant argues that the ultimate compensation should be decided on the basis of empirical evidence that a resource subject to mitigation is not sufficiently recovering variable costs. CAISO feels that this issue has been decided in prior FERC orders on the definition of the DEB and is outside the scope of the present process.[8]

OPTIONS FOR SUPPLEMENTAL PRICING

Over the course of the stakeholder process to consider supplemental pricing, CAISO considered a number of options, including:

(a) not mitigating the Bids of resources without capacity contracts;

(b) allowing such resources to get paid their Bids but limiting supplemental payments (over revenues that would accrue if mitigated) with a revenue cap (which was called "relaxed" mitigation); and

(c) mitigating Bids but providing a specific supplemental payment based on either (i) a daily capacity payment similar to the current Reliability Capacity Services Tariff (RCST) and proposed Transitional Capacity Pricing Mechanism (TCPM) recently filed with FERC) or (ii) a Bid Adder similar to the FMU Bid Adder described above.

After consideration of the advantages and disadvantages of each option, and getting stakeholder comments on a White Paper and subsequent Straw Proposal, CAISO concluded that two options were most viable.

The first option was to mitigate Bids to the DEB but then add the FMU Bid Adder to the final payment. As noted, this Bid Adder is $24/MWh and has been approved by FERC for use in market price setting. If used for Exceptional Dispatch, the payment would be the higher of the LMP or the DEB plus the Bid Adder. Hence, if the LMP was $40/MWh and the mitigated unit's DEB was $30/MWh, its payment would be the higher of $40/MWh or $54/MWh ($54 = $30 + $24). After some consideration, CAISO also determined that this supplemental payment should be subject to a revenue cap equal to the monthly ICPM payment. This would ensure that this resource would accept the ICPM offer if made subsequently to Exceptional Dispatch. Importantly, the revenue cap does not restrict the mitigated resource from collecting LMP revenues in excess of its DEB, it only cuts off the additional Bid Adder revenues if Exceptional Dispatches are frequent and allow the supplemental revenue cap to be reached.

The second option was simply a "relaxed" version of the first: the resource would be paid its unmitigated Bid (which could thus be up to the Bid Cap, which will be $500/MWh at the start of MRTU) for each hour of Exceptional Dispatch. Any revenues above the mitigated level, as with the Bid Adder option, would accrue against the revenue cap equal to the monthly ICPM payment. CAISO introduced this option in the second round of stakeholder discussion because it offers an opportunity for a resource to much more rapidly accrue a supplemental payment.

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[8] In the September 21, 2006 Order, FERC stated that the variable cost plus 10% option would be sufficient to cover the various operating costs and "While this option accounts for a supplier's operating cost, we note that a supplier whose bid is mitigated to cost plus ten percent will also have an opportunity to recover its fixed costs during times when it is not the marginal unit that sets the market clearing price in the market." FERC also cited lack of evidence presented for the argument that the 10% adder would be insufficient. The FERC order can be found at: http://caiso.com/1878/1878f9725ef80.pdf with specific reference to paragraph 1045 for the FERC Determination. In addition to the Variable Cost Option for determining a DEB, resources can choose an LMP based DEB or the Negotiated Rate Option, which allows for a unique DEB to be negotiated with an independent entity.

Because it is possible to reach the ICPM payment in a relatively few hours, this approach is similar in some circumstances to supplier views, as expressed in filings to FERC, that an Exceptional Dispatch should lead automatically to an ICPM designation of one or more months. As noted above, in its filings to FERC, CAISO has argued against such a "hard trigger" for ICPM designation, since not all Exceptional Dispatches are evidence of an enduring "Significant Event." However, this relaxed mitigation pricing rule could essentially lead to the same financial outcome if the unit being Exceptionally Dispatched is uniquely needed by grid operators for locational reasons and can thus submit a high Bid.

One disadvantage of the second option, when compared to the first, is that there is remaining uncertainty about the scope of Exceptional Dispatch and at least in some circumstances, where there are few competing units, a resource could garner significant rents not consistent with the market and system conditions at the time. In fact, in what are likely to be rare cases, a resource could earn the ICPM revenues under Exceptional Dispatch in a short period and then be offered the ICPM payment for a subsequent month if CAISO declares a Significant Event, thus earning twice the ICPM payment in little more than one month. On the other hand, in locations where multiple units might be available for Exceptional Dispatch, this bid-based approach will allow CAISO operators to select from alternative competing bids to meet operational needs, and so the additional revenues may accrue more slowly.

Another concern that is more accentuated under the second option is that in some situations, a resource subject to Exceptional Dispatch may reject an ICPM offer of designation for some period if it calculated that it could earn twice the ICPM monthly rate in little more than a month. This is certainly more likely under the second option. However, to obtain the Exceptional Dispatch payment, a resource must submit a Bid into the markets; hence it would be eligible for selection through the markets and at least remain visible to grid operators during the early phase of an ICPM Significant Event. Ultimately, a resource that chose to delay its acceptance of an ICPM offer would take the risk that CAISO could find other resources for ICPM designation that meet the reliability needs.

Under either supplemental pricing option, Exceptional Dispatch revenues subject to the revenue cap would be measured as total payments for incremental energy under Exceptional Dispatch (higher of Bid or LMP) minus the payments that would have taken place if the unit had been mitigated to DEB. That is, for a unit subject to Exceptional Dispatch with a Bid or LMP of $100/MWh and a DEB of $50/MWh, it is the $50 difference per MWh that is providing a contribution to fixed costs.   It is this difference that will be tracked over the month for purposes of determining when a unit reaches its supplemental revenue cap.

To give some indication of the value of the revenue cap, CAISO has filed with FERC that the ICPM annual rate would be $41/kW-year or a higher rate for any particular unit that files with FERC showing that its going forward costs are higher than this rate. FERC has not yet approved this rate, but assuming this rate for purposes of illustration, the maximum ICPM monthly payment for a 100 MW unit (that does not file for a higher rate) would be $41/kW-year × 1/12 months per year × 1000kW/MW × 100 MW = $341,667. This unit could thus hit the revenue cap after approximately 7-10 hours of Exceptional Dispatch if it was able to get selected with an Offer at the Offer Cap of $500/MWh and depending on the value of its DEB. If FERC ultimately approves a different rate or rate formula for ICPM, the revenue cap would change accordingly.

There are a number of other similarities between the two options. Under both options, when a supplier hits the revenue cap, it would be subject subsequently, for the remainder of the 30 day period beginning with the first Exceptional Dispatch, to full mitigation (i.e., higher of LMP or DEB). Similarly, under both options, the resource would have to submit a Bid into the CAISO day-ahead and real-time markets to receive the supplemental payments, consistent with current Tariff rules. Both types of Bid-based supplemental payments would be provided only for incremental energy provided above the resource's minimum operating level. The start-up and minimum load components of the Offer are not subject to daily mitigation and moreover the MRTU Tariff already offers two options for determining these components, one based on costs and the other as high as 200 or 400 percent of costs (see section 30.4 of the MRTU Tariff). Both options have the advantage that they do not require negotiation

of any new tariff rates: The FMU Bid Adder is already approved in the MRTU tariff and the Relaxed Mitigation approach relies on voluntary Bids. The ICPM monthly rate is expected to be approved by FERC before MRTU start-up. Also, both options have similar administrative and implementation requirements.

Under either option, the CAISO proposes that a sunset provision be added to the revised MRTU Tariff language to coincide with the expiration of ICPM at the end of 2010. This provision would be added based on the assumption that over the first couple of years of operations the CAISO would be able to reduce the amount of Exceptional Dispatches issued. If, at the end of 2010, actual experience indicated that market power issues associated with Exceptional Dispatch are still frequent enough to warrant maintaining the mitigation then the CAISO would file an extension of the mitigation provisions.

POSITIONS OF THE PARTIES

The second phase of the stakeholder process included the following steps which allowed for three written comment opportunities and four public opportunities for stakeholders to express their opinions and react to CAISO proposals and MSC views:

Step #	Date	Process
1	March 21, 2008	Issue Paper posted
2	March 28, 2008	Conference call to discuss issue paper
3	April 4, 2008	Comments due on Issue Paper
4	April 11, 2008	MSC stakeholder meeting on Exceptional Dispatch
5	April 14, 2008	Straw Proposal posted
6	April 15, 2008	CAISO stakeholder meeting on Straw Proposal
7	April 17, 2008	Conference call with MSC Chair
8	April 24, 2008	Comments due on Straw Proposal
9	May 7, 2008	Draft Final Paper posted

LSEs and generation stakeholders were fairly divided on the pricing options, with positions generally following their respective stakeholder segments. Listed below are the general positions of each of the entities that provided comments on the second CAISO paper (the Straw Proposal), with the exception of Calpine that only provided comments on the first Issues Paper. For more detailed comments please refer to the stakeholder matrix (Attachment A).

Company	Summary of Main Comments
Calpine Corporation	Prefer no mitigation of Exceptional Dispatch Bids; also prefer designation of any non-RA resources subject to Exceptional Dispatch for a backstop capacity payment at a higher rate than the proposed ICPM payment.
Dynegy	Opposes supplemental payments as proposed; prefers designation of any non-RA resources subject to Exceptional Dispatch for a backstop capacity payment at a higher rate than the proposed ICPM payment.
Reliant	Opposes mitigation as proposed. Prefers designation of any non-RA resources subject to Exceptional Dispatch for a backstop capacity payment at a higher rate than the proposed ICPM payment; revise DEB to consider additional variable costs.
WPTF	Opposes mitigation as proposed; revise DEB to consider additional variable costs.

Company	Summary of Main Comments
CDWR/SWP	Did not support either option.
CPUC	Evaluating relaxed mitigation option.
PG&E	Supports bid adder option
SCE	Does not oppose relaxed mitigation option.
Six Cities	Supports bid adder option

DMM / MSC FEEDBACK

The Department of Market Monitoring (DMM) was involved in all aspects of this stakeholder process. In addition, the MSC (with Frank Wolak as the MSC Advisor) provided its views on the CAISO proposals and alternatives and held public discussions with parties through their stakeholder process.

The MSC held a stakeholder meeting on April 11, 2008 during which the CAISO presented an overview of the initial issues paper and then the MSC members discussed aspects of the Exceptional Dispatch proposal with their stakeholders. This discussion was continued through a conference call on April 17, 2008 with two of the MSC members so that they could hear further comments on the CAISO proposal. In between the MSC meetings on April 11th and 17th the CAISO also held a stakeholder meeting on April 15th to discuss the Straw Proposal.

Both the DMM, in the monthly Market Monitoring Report, and MSC, in their formal opinion adopted on May 6th (Attachment B), have stated their support of the mitigation aspects of Exceptional Dispatch as well as the Management proposal, discussed next, to select the Relaxed Mitigation pricing option.

MANAGEMENT RECOMMENDATION

Management's recommendation is to implement the mitigation of Bids for Exceptional Dispatch as proposed by the DMM, augmented by the option to "relax" Bid mitigation for eligible suppliers without RA, RMR or ICPM contracts, subject to the revenue cap based on the ICPM monthly payment. However, Management recommends that this pricing approach is implemented in a two-stage process. For the first two months of MRTU, all Bids of eligible suppliers subject to mitigation will be augmented with a $24/MWh Bid Adder. This more restrictive initial approach will allow market and system operations time to evaluate systematic modeling issues that lead to Exceptional Dispatch and correct as many as possible without exposure to extraordinary costs. In the beginning of the third month, the relaxed mitigation would be implemented and the Bid Adder removed.

Management believes the relaxed mitigation approach balances the interests of the Load Serving Entities with the interests of the suppliers and is consistent with the pending ICPM filing. Suppliers will be able to potentially accrue supplemental payments more rapidly in certain circumstances than in the alternative considered. At the same time, buyers would typically be exposed to no more than the monthly ICPM payment in supplemental revenues over and above the revenues that would accrue under mitigation.[9] Moreover, as noted above, the MSC supports this option. ICPM is due to expire in December 2010. Accordingly, Management proposes that the proposed rules for mitigation and supplemental pricing under Exceptional Dispatch also expire with ICPM and new rules, if needed, be considered on the basis of market experience.

As evidence of Management's balancing of competing interests, this proposal does not fully satisfy any group of stakeholders. LSEs and the CPUC prefer the lower supplemental payments under the $24/MWh Bid Adder. Suppliers argue against mitigation of Exceptional Dispatch Bids, although some have indicated that if such mitigation is imposed, the relaxed mitigation is preferred. In developing this proposal and refining it towards a

[9] By allowing relaxed mitigation, there is more risk that suppliers will be able to exercise market power in the short term, i.e. up to the revenue cap.

recommendation of the relaxed mitigation approach, the CAISO added a further requirement that Bid mitigation would apply and a $24/MWh bid adder would be made until the third month of MRTU operations. This would protect buyers from extraordinary payments during a time which is likely to require relatively more Exceptional Dispatches. Although this further refinement of the proposal was not subject to stakeholder consideration, Management believes its proposal to be just and reasonable and to balance both load serving and supplier interests.