To: CAISO
Market Surveillance Committee (MSC)

From: Karen Paull, Division of Ratepayer Advocates of the CPUC

Re: Bilateral Trading Group (BTG) Comments on CAISO's "Final Proposal for Interim Capacity Procurement Mechanism Tariff Filing" issued November 9, 2007 ("revised ICPM proposal"), and the MSC's Opinion on that proposal (Draft issued 11/19, adopted with changes 11/21)

Date: November 21, 2007

Although the Market Surveillance Committee (MSC) adopted its Opinion on the CAISO's revised ICPM proposal this morning (November 21), the BTG believes that the issues raised in the MSC's Opinion merit further consideration by the CAISO, and therefore submits these comments on some of those issues.

The BTG views the revised ICPM proposal as a big improvement over the earlier version, and views most of the changes as positive. However, BTG supports the MSC's recommendations to:

- place the responsibility for Type 1 procurement in the first instance with the CPUC [or appropriate Local Regulatory Authority, in the case of publicly-owned utilities)], and
- make the ICPM designation mandatory.

These points are addressed in the comments that follow on Type 1 Capacity procurement under the revised ICPM proposal.

1. **<u>Type 1 Capacity</u> [procured in advance of the RA compliance year, or conceivably during the compliance year in the unlikely event an LSE has not procured the full amount of its RAR in the month ahead time frame]**

   Note: the comments in this section, following this paragraph, assume that the CAISO would be the entity procuring the capacity to make up the shortfall for the coming compliance year, as proposed in the CAISO's revised ICPM proposal. However, the MSC, in its Draft Opinion issued on November 19, 2007, recommends that the authority for Type 1 procurement be assigned to the CPUC as the appropriate regulatory authority for the investor-owned utilities. BTG supports this recommendation. BTG notes that a similar arrangement would work for non-CPUC utilities by assigning this responsibility to the appropriate Local Regulatory Authority (LRA). Under the circumstances in which Type 1 procurement would be undertaken, there is sufficient time for the CPUC or LRA to order any LSEs subject to their jurisdiction to rectify a capacity shortfall by means of an RFO process. This approach would likely be a more cost-effective way to rectify any capacity shortfall for which CPUC-jurisdictional LSEs and LRA jurisdictional LSEs are responsible.

Type 1 capacity is defined as the capacity that the CAISO will need when LSEs have not made sufficient Resource Adequacy (RA) capacity procurement to meet their RA requirements for the coming compliance year.

For Type 1 target, the CAISO proposes the following criteria to set the annual capacity payment:

a.) Falls within the range of just and reasonable prices established by FERC in the RCST settlement;

b.) Does not create incentives for buyers or sellers to shift procurement to the ICPM;

c.) Induces suppliers to voluntarily accept designation; and,

d.) Offers an opportunity for a simple auction in the event that excess suppliers are available at the target price offer.

The CAISO then proposes to offer suppliers an interim Type 1 target capacity of $41/kW-year that will not be subject to a Peak Energy Rent (PER) deduction.

BTG agrees with the above criteria proposed by the CAISO for Type 1 target annual capacity price. The best way to achieve the goals set in the above four criteria would be capacity procurement of ICPM Type 1 by means of issuing an RFO, when there are enough suppliers to make an RFO feasible, and requesting sealed offers from suppliers up to the maximum price. (The MSC pointed out in the November 21 meeting on their Opinion that an auction process may not be feasible for local capacity procurement due to the very limited number of suppliers in local areas. They acknowledged, however, that an RFO process could be a preferred way to cure a deficiency in systemwide capacity.)

For Type 1 procurement, there is adequate time available for an RFO process. In such a process $41/kW-year would in effect be the price cap. Suppliers will make offers based on prices that have been deemed just and reasonable and the appropriate entity (preferably the CPUC and LRAs in the first instance but if necessary the CAISO) will make its selection based upon such offer prices and procure up to the target level. Selected suppliers will be paid their offer prices. Following this process, the target level of RA capacity will be purchased and cost to customers will be minimized. In the event that limited suppliers are available, it is likely that the CAISO would simply need to pay the capped price of $41/kW-year to every supplier.

The RFO process described above would satisfy all of the four criteria specified by the CAISO. Payment would be within the range of just and reasonable prices. The process would not create incentives for buyers and sellers in the bilateral market to shift procurement to the ICPM market. There would be simple rules for selection of suppliers when the level of supply is more than the target level. Furthermore, the RFO process for the selection of the supplier for Type 1 capacity would be very similar to the current methods used by IOUs and LSEs in the bilateral market (under CPUC supervision, in the case of the IOUs).

With respect to making participation in ICPM market voluntary, however, BTG supports the MSC's recommendation to make the ICPM designation mandatory rather than optional, because only owners with substantial market power would refuse the designation (MSC Open., pp. 5-6.) As discussed in the MSC meeting of November 21, this requirement (of mandatory ICPM designation) is essential for procurement of local area capacity.

2. **Type 2 Capacity [procured during RA compliance year in case of "Significant Event"]**

In Type 2 capacity procurement, due to the occurrence of a Significant Event, there may not be sufficient time to go through the RFO process. Furthermore, there is a good chance that the available supply after a Significant Event will not be in excess of the CAISO's target level procurement. The CAISO could make the selection of the suppliers and sign contracts for one month at $41/kW-year.

However, if the CAISO after its evaluation finds out that the impact of the Significant Event will be lasting more than one month and that the CAISO will need capacity after the first month, then the CAISO will have time to go through an RFO process to select supply or suppliers for the second months and beyond. Such an RFO process would be similar to the one for Type 1 capacity.

Recommendation

The CAISO should ask the CPUC and appropriate LRAs to supervise Type 1 capacity procurement in the first instance, and should seek authority to supervise such procurement itself only as a secondary backstop. If the CAISO does conduct that procurement in the first instance, it should utilize a RFO process with sealed offers to select suppliers for Type 1 capacity, whenever sufficient suppliers exist, with payments at offer prices with a cap of $41/kW-year. (Per the revised Proposal, the capacity payments would not be subject to a PER deduction.)

For Type 2 capacity, due to the occurrence of a Significant Event, the CAISO could select suppliers for the first month at a payment of $41/kW-year. If the need is going to last for more than one month, then the CAISO will have time to select suppliers using an RFO process for the second month and beyond.