Comments of: Constellation Energy, NRG Energy and Reliant Energy

Re California ISO DMM Exceptional Dispatch Mitigation Proposal[1]

Background

On 12/3/2007, the CAISO Department of Market Monitoring (DMM) issued for comment a proposed tariff provision to limit the potential exercise of market power in the event exceptional dispatches for energy are needed to meet reliability constraints that cannot be resolved through the MRTU market software.[2]

Generally speaking, exceptional dispatches are triggered as a result of a forced transmission or generation outage or local reliability constraints that are not modeled in market software. Exceptional dispatches are similar to current out-of-sequence (OOS) and out-of-market (OOM) actions that may be taken by CAISO operators to address a reliability issue that cannot be resolved through CAISO market software or dispatches of Reliability Must Run (RMR) units. The DMM proposal would not be applied for any exceptional dispatches made for system energy constraints. The DMM proposal, at page 3, and the October 2007 DMM Exceptional Dispatch discussion paper provides further examples of exceptional dispatches.[3]

The DMM proposes to mitigate the bids of generating units exceptionally dispatched for non-system-level reliability requirements by paying the higher of:

- The unit's Default Energy Bid (DEB) or
- LMP.[4]

Currently, the CAISO tariff provisions, a unit that is subject to Exceptional Dispatch would be paid the higher of:

- The unit's Energy Bid price
- The unit's Default Energy Bid (DEB) or
- LMP

Therefore, a key difference between the DMM's proposed approach and current tariff provisions is that under the DMM proposal, units would be precluded from being paid their energy bid on the apparent presumption that such bids would never lead to competitive market outcomes. Furthermore, the proposal seems to preclude an Exceptional Dispatch unit from setting the LMP for that location.[5] Eliminating the ability for units that are subject to Exceptional Dispatch to be paid their energy bids is an unwarranted tariff change, especially in light of the fact that Exceptional Dispatch does not, pursuant to existing tariff provisions, set the market clearing price.

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[1] CAISO Department of Market Monitoring, Mitigation of Potential Market Power Under MRTU Exceptional Dispatch Provisions ("DMM Proposal"), *available at*: http://www.caiso.com/1c89/1c89d76950e00.html
[2] *Id.* at 2.
[3] Exceptional Dispatch and Proposed Interim Capacity Procurement Mechanism, October 22, 2007, *available at*: http://www.caiso.com/1c7f/1c7fe9985c80.pdf
[4] DMM Proposal at 5.
[5] *Id.* at 6.

If the CAISO intends to further pursue this tariff modification, it should convene a stakeholder process to further vet the issues raised in the comments below.

Comments

1. DMM Proposal inappropriately assumes Exceptional Dispatch is always a circumstance where there is abuse of Market Power

Except for exceptional dispatches used to procure system energy, the proposal categorically presumes that there is an abuse of market power every time Exceptional Dispatch is necessary, and therefore the DMM proposes to make such units ineligible to receive its energy bid price. This is in addition to the existing CAISO tariff provisions that preclude Exceptional Dispatch from setting the clearing price, which was approved by FERC, as follows:

> LMPs should reflect the marginal cost of energy, in order to send accurate price signals. However, manual Exceptional Dispatch instructions differ from those derived from the real-time market optimization software. Units manually dispatched in Exceptional Dispatches need not represent the marginal units, and thus, we agree with the CAISO that it would not be appropriate for such units to set the market price.[6]

The DMM proposal goes far beyond the prohibition with respect to setting the clearing price in seeking to disallow payment of energy bids at all to units that are subject to exceptional dispatch - a disallowance proposed without analysis to demonstrate that market power is being exercised, much less that there is any abuse of market power when a generator is following the CAISO's exceptional dispatch instructions. Mitigation should be used to address market power, not to mitigate prices when there is no market power. Under MRTU, market dispatches are subject to mitigation in local areas (LMPM). However, CAISO's proposal for exceptional dispatch goes far beyond the LMPM procedures under MRTU in which bids are mitigated only when they are used to resolve congestion on non-competitive constraints.

Unlike current LMPM tariff provisions, there would be no way to know if market power exists by a provider of energy under an exceptional dispatch unless the CAISO was to assess whether market power is present before imposition of mitigation. To automatically declare, however, that all exceptionally dispatched generating units can exercise market power, as the DMM proposal does, is unreasonable.

Recommendation: If new mitigation measures are to be imposed at all for exceptional dispatch, the DMM should develop a set of clearly defined market power metrics to test the presence of market power necessitate market power mitigation in excess of that provided for in the LMPM measures - before categorically preventing an exceptionally dispatched generating unit from being able to secure a payment equal to its energy bid. The CAISO should not be permitted to impose any new mitigation measures until FERC has received and approved of appropriate screening methodologies for the determination of market power.

[6] *Id.* at 5, quoting FERC September 21, 2006 Order on MRTU at P266.

2. DMM Proposal appears to directly conflict with the CAISO efforts to implement an Interim Capacity Procurement Mechanism

Capacity from Resource Adequacy generating units has a general obligation to bid into day ahead and, if committed, real time markets in the CAISO. Thus, it is unlikely such capacity will be subject to Exceptional Dispatch. It would appear more likely that non-RA contracted capacity may be the focus of exceptional dispatch. In its most recent proposal for an Interim Capacity Procurement Mechanism (ICPM)[7], CAISO identified non-RA backstop procurement as a tool that may reduce the occurrence of exceptional dispatches. Under this DMM proposal, however, the price paid for Exceptional Dispatch looks much more like the existing Must Offer Waiver Denial process that FERC has already determined to be unjust and unreasonable. Indeed, this DMM proposal will inappropriately mitigate downward exceptional dispatch prices and the price for RA capacity and non-RA backstop capacity procurement will be commensurately reduced – thereby effectively continuing the FERC Must-Offer Obligation with a method of compensation that is unjust and unreasonable in the absence of a capacity payment for providing the reliability services.

Recommendation: It appears that the DMM proposal may undermine the separate efforts underway to ensure just and reasonable compensation for RA capacity or non-RA backstop capacity providing reliability services. To prevent both under-compensation and over-reliance on exceptional dispatches, mitigation of exceptional dispatches should only occur when the CAISO can demonstrate market power, and in no event should units that are subject to Exceptional Dispatch be precluded *a priori* from being paid their energy bids.

3. DMM Proposal may encourage increased operator reliance on Exceptional Dispatches

The DMM proposal lacks precise guidelines as to when the CAISO may use exceptional dispatches other than to indicate that these instances should be “rare.” Notwithstanding the CAISO’s characterization, there is no assurance or evidence that exceptional dispatches would be rare. Moreover, the proposed mitigation will artificially reduce the cost of, and perversely increase reliance on, exceptional dispatches to reliability services. This lack of clarity about when and how Exceptional Dispatch is called along with this DMM proposal to reduce the payment for Exceptional Dispatch raises a serious concern that this proposal will lead to increased reliance on Exceptional Dispatch.

Recommendation: While the MRTU tariff at Section 34.9 generally illustrates examples of exceptional dispatches, the CAISO should articulate the precise circumstances in which it may use Exceptional Dispatch. To the extent enhanced clarity is not proposed there should be no modification to the tariff with respect to what price an exceptionally dispatched unit will be paid.

[7]See ICPM proposal of 11/09/2007, ***available at***: http://www.caiso.com/1bc5/1bc5db284cc80.html. As of the date of these comments, the CAISO has not filed its draft ICPM proposal at the FERC and may still be under further development.