J.P. Morgan Comments on CAISO Straw Proposal "Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch"

Submitted By	Company	Date Submitted
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J.P. Morgan Ventures Energy Corporation and BE CA, LLC (collectively, "J.P. Morgan") appreciates this opportunity to provide comments on the California ISO's (CAISO's) July 15, 2010, Straw Proposal entitled "Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch" ("Straw Proposal").

J.P. Morgan supports the CAISO's efforts to revisit and update the existing Interim Capacity Procurement Mechanism and Exceptional Dispatch Pricing and Bid Mitigation. J.P. Morgan supports establishment of a CAISO Capacity Procurement Mechanism that complements, and is aligned with, the requirements and incentives under the California Public Utilities Commission's ("CPUCs") Resource Adequacy program and provides the CAISO with the operational tools it needs to reliably operate the system. J.P. Morgan also supports development of Exceptional Dispatch pricing that is fair and appropriately compensates resources for the capacity they make available to the CAISO.

J.P. Morgan agrees with the CAISO that there are a number of critical, parallel, and related efforts that together will determine whether California will be successful in establishing the market/regulatory rules necessary to attract and maintain investment in the resources needed to reliably serve load and operate the power system. As acknowledged by the CAISO, these efforts include evolution and refinement of the CPUC's/CAISO's resource adequacy requirements, refinement of the CPUC's Long-Term Procurement Plan ("LTPP") rules, CAISO market design enhancements, and the process for replacement of resources that rely on Once Through Cooling technology.

Consistent with J.P. Morgan's previous comments in this matter and in other venues, if these efforts are to be successful, the CAISO must: 1) endeavor to price in its markets all known and observable CAISO operating requirements (and thus reduce out-of-market operator actions like Exceptional Dispatch and transmission limit biasing); 2) endeavor to transparently reflect the true costs of meeting all operational requirements (such as the need to commit units at minimum load) in market prices; and 3) ensure that resources needed to satisfy CAISO market and operating requirements are fairly compensated and that such compensation establishes appropriate incentives for new and existing resources (be they generation or demand-based) to make themselves available to satisfy the CAISO's requirements. As acknowledged by the CAISO, once defined and priced by the CAISO, these operating requirements can be appropriately factored into and influence necessary forward planning efforts and contracting.

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.

Consistent with its earlier comments J.P. Morgan recommends that whatever Capacity Procurement Mechanism developed to backstop RA procurement be established on a permanent basis, or until changes to the mechanism are needed to align it with changed CPUC RA requirements/procurement rules. To the extent that such capacity is market priced, permanent provisions could work. However, administrative or fixed pricing would require periodic updating, perhaps every two years.

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?

J.P. Morgan believes that it is reasonable to pro rate the revenues due a CPM resource based on the number of days it is out on a planned outage. However, consistent with its earlier comments, the CAISO should explicitly allow resources to provide equivalent substitute capacity from another resource for the days when the Exceptional Dispatch resource is out of service and allow a resource the explicit option of rescheduling its planned outage. Resources that are offered a CPM designation should have priority in rescheduling previously planned and approved outages.

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.

In concept, J.P. Morgan supports establishing a criterion for choosing among available resource based on the CAISO's expectation that the resource will be available during the applicable CPM designation period. However, J.P. Morgan does not support establishing a criterion that automatically excludes use-limited resources. The CAISO receives resource plans from use limited resources and thus should be able to make an explicit and objective determination whether a resource will be available during the applicable CPM designation period. In summary, while J.P. Morgan is not opposed to consideration by the CAISO of a resource's use-limited status when selecting among available resources to satisfy a CPM need, the CAISO should consider available information on a use-limited resource's status/availability during the CPM designation period.

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

The CAISO proposes three additional types of backstop procurement of generic capacity: 1) capacity to allow planned maintenance to occur; 2) capacity to backstop observed less-than-planned output from intermittent resources; and 3) capacity needed for reliability that is in danger of shutting down due to lack of sufficient revenues.

As stated previously in a number of forums, J.P. Morgan recommends that the CAISO explicitly identify its system operating needs/requirements and to procure through market based mechanisms or products (be they new or existing) the resources that possess the desirable operational characteristics. In addition, J.P. Morgan is supportive of refining the CPUC's existing "least cost, best fit" Long-Term Procurement Plan ('LTPP") guidelines and RA requirements to ensure that load-serving entities forward procure the type of capacity necessary to satisfy the CAISO's requirements.

In this context, J.P. Morgan is concerned that the three identified additional types of backstop capacity needed by the CAISO may in fact indicate deficiencies in the larger RA requirements. J.P. Morgan questions whether the existing RA system and local reserve margins are adequate and whether the counting conventions for certain RA resources are reasonable based on expected availability. Similar concerns with the RA and LTPP requirements exist if resources needed for reliability are not under contract and need to be procured by the CAISO.

Notwithstanding these concerns and recognizing the timeframe in which necessary refinements to the RA and LTPP program can be implemented, J.P. Morgan appreciates the need for the CAISO to have backstop authority to procure additional capacity. Moreover, in light of the need for a transparent price for capacity that can appropriately guide forward contracting, a reasonable CAISO-established price for capacity may be necessary until longer-term reforms can be implemented.

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.

J.P. Morgan supports Option A. A CONE-based pricing structure provides appropriate compensation to capacity resources, establishes appropriate incentives for both resource providers and load-serving entities, and is aligned with the resource adequacy program. While a market clearing pricing mechanism may be a more preferable long-term approach to pricing capacity, J.P. Morgan supports the CAISO's proposal to use an administratively determined demand curve. J.P. Morgan agrees with the CAISO that a "net CONE" methodology will "provide additional price signals for capacity development in locations that are in RA supply shortage or close to being in shortage" and will "provide the RA market with a more transparent locational price" and will "control for market power." Most importantly, the net CONE approach will, as stated by the CAISO, "support efficient forward–procurement of resource adequacy" and "…market supply conditions (i.e., scarcity/surplus) and forward prices would be positively correlated." As recommended by the CAISO, J.P. Morgan also supports use of the referenced California Energy Commission ("CEC") study to determine the CONE (CEC, *Comparative Costs of California Central Station Electricity Generation,* January 2010).

At this juncture, J.P. Morgan's primary concern with the CAISO Option A proposal is the level of the price floor (set at going-forward fixed costs) and the slope of the demand curve. Both the level of the price floor and the slope of the curve should not obviate the important price signals and incentives established through the CPM mechanism, e.g., the price signals necessary to guide forward contracting and the incentive for both new and existing resources to be made available to service load and reliably operate the system. While J.P. Morgan recognizes that the procurement timeframe for the CPM is 12 months or less, and thus practically excludes new entry from addressing any identified deficiency, the CPM price can and should nonetheless influence forward contracting. Therefore, it may be appropriate to set the price floor at a level higher than going-forward fixed costs, perhaps at some fixed percentage of CONE.

In addition, there is an inexorable relationship between the level and shape of the demand curve and the CAISO's requirements for capacity. The CAISO proposes to set the curve based established RA requirements. While in principle this makes sense, the CAISO Straw Proposal acknowledges that its capacity requirements (and the operational characteristics it desires) may be in excess of or different than those defined by the RA requirements. If so, then the proposed demand curve may not accurately reflect the "right" price for capacity. The CAISO must endeavor to ensure that the shape/level of the demand curve is set in a manner consistent with its capacity/operating needs.

Finally,, although not specifically addressed in its earlier comments, J.P. Morgan supports the "net CONE" methodology discussed by the CAISO and development of a reasonable peak energy rent reduction (PER). J.P. Morgan recommends that the CAISO develop a unit-specific PER methodology, rather than a PER methodology based on a hypothetical proxy resource. A unit-specific PER provides a more reasonable level of compensation an does not unnecessarily penalize older resources that provide generic capacity services to the CAISO.

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

See response to item (4) above. J.P. Morgan recommends that the CAISO explicitly identify and quantify its operating requirements and then procure through market-based mechanisms the resources necessary to satisfy those requirements. J.P. Morgan understands that this is a primary objective of the CAISO's recently initiated renewable integration and ancillary service/market product review. J.P. Morgan requests that the CAISO clarify the intended outcome and timing of these parallel efforts (CPM and Renewable Integration) and further explain the need to expand its CPM authority to procure non-generic capacity.

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?

As stated above, and as a general matter, J.P. Morgan recommends that the CAISO explicitly identify its system operating needs/requirements and to procure through market based mechanisms or products (be they new or existing) the resources that possess the desirable operational characteristics. The CAISO has begun to do so by, in part, defining certain needed characteristics, e.g., fast ramping capability. J.P. Morgan urges the CAISO to go further and also identify and define through technical studies its dynamic system stability requirements, such as the inertia necessary to support the CAISO's frequency response requirements and more generally the inertia and capacity related requirements needed to support anticipated imports, both an CAISO-wide as well as a sub-regional basis. In addition, J.P. Morgan recommends that the CAISO define its capacity reserve requirements for responding to certain contingencies; contingencies for which it may not be able, or want, to use available operating reserves. As understood by J.P. Morgan, the production cost simulation based studies performed to date by the CAISO do not necessarily reveal the CAISO's dynamic system stability requirements. J.P. Morgan urges the CAISO to conduct the technical studies necessary to define these requirements.

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?

J.P. Morgan recommends that "non-generic" capacity, i.e., capacity with operational attributes of value to the CAISO, be prices through market-based mechanisms. While a price adder, such as that proposed by the CAISO, may be a possible interim approach, consistent with its earlier comments in this process J.P. Morgan recommends that any such price-adder have an explicit sunset date and that the CAISO immediately examine market-based approaches to pricing non-generic capacity.

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?

As stated in its previous comments, J.P. Morgan recommends that resources Exceptionally Dispatched for energy only be mitigated in circumstances where there is a clear demonstration of market power, i.e., in circumstances where a resource can reasonably foresee the need for their resource in order to address a CAISO requirement. J.P. Morgan is concerned that under the existing Exceptional Dispatch mitigation resources Exceptional Dispatched to address a need on a “non-competitive” path may be unnecessarily mitigated. Under the CAISO’s existing Competitive Path Assessment (CPA) methodology, the competitiveness of only a limited number of paths is reviewed seasonally and most paths are deemed “non-competitive” by default. Unless the CAISO can clearly demonstrate an ability to exercise market power, resources needed to address congestion should not b automatically mitigated.

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 answer to item (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?

Yes. Consistent with its earlier comments, J.P. Morgan recommends that resources committed under the CAISO’s Exceptional Dispatch authority be paid the monthly CPM price, as established through this process. Resources Exceptional Dispatched for energy should be paid the higher of their bid price or the LMP at their location.

Other

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