Comments of J.P. Morgan

Subject: Updating Interim Capacity Procurement Mechanism And Exceptional Dispatch Pricing and Bid Mitigation

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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) June 9, 2010, Issue Paper entitled "Updating Interim Capacity Procurement Mechanism, and Exceptional Dispatch Pricing and Bid Mitigation" ("Issue Paper").

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.

<u>Interim Capacity Procurement Mechanism</u>

1. Please provide your thoughts on the duration of the tariff provisions associated with a successor to the Interim Capacity Procurement Mechanism ("ICPM") and whether the tariff provisions should be permanent, i.e. there would not be a sunset date, or have some specified termination date. If you have a specific proposal, please provide it and indicate the reasons for your proposal.

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 procurement rules. To the extent that such capacity is market priced, permanent provisions could work. However, administrative or fixed pricing would require periodic updating. With respect to the other capacity needs, as noted below, J.P. Morgan recommends that the CAISO rely on market-based products and mechanisms in the first instance. However, to the extent that the CAISO believes it necessary to retain the tariff authority to procure such capacity via a CPM-like mechanism, then J.P. Morgan recommends that such provisions be only established on an interim basis until the requisite market products can be developed. J.P. Morgan suggests that a hard sunset date will establish the appropriate incentives for the CAISO and participants to develop the necessary products. J.P. Morgan recommends that these provisions sunset two years from implementation.

2. Please provide your thoughts regarding the compensation that should be paid for capacity procured under ICPM and Exceptional Dispatch. If you have a specific proposal, please provide it and indicate the reasons for your proposal.

As a general matter, J.P. Morgan recommends that the CAISO rely on market-based products and mechanisms to satisfy its capacity requirements. Reliance on market-based products and mechanisms will provide the transparent price signals necessary to ensure market development of the capacity and products needed to serve load and reliably operate the system. Consistent with the CPUC's existing rules, Resource Adequacy capacity should first be procured through open market solicitations, or Requests for Offers ('RFOs"). To the extent that the CAISO must procure backstop RA capacity, that capacity should be priced on a basis consistent with the intent of the RA program, namely to create incentives for the development of the capacity needed to serve load and provide a reserve margin. In other words, that capacity should be based on a reasonable estimation of the Cost Of New Entry ("CONE'). J.P. Morgan posits that a reasonable starting place is the estimated cost of new capacity detailed in the CAISO Department of Market Monitoring's recent Annual Report on Market Issues and Performance. That report states that the cost of a new combined cycle facility is \$191/kW-year and the cost of a new combustion turbine is \$212/kW-year. While J.P. Morgan is cognizant of the CAISO's desire to not create incentives that would shift suppliers to rely on a backstop mechanism, in the absence of a transparent forward price for RA capacity it is appropriate for the CAISO to establish a price for backstop that is aligned with the central purpose of the RA program and is necessary to attract new investment. In the Issue Paper the CAISO summarizes its previous deliberations on this matter which concluded that, "…the backstop mechanism is not intended to provide entry price signals." and that since, "…it is only procuring capacity from existing resources, the price should be based on the going-forward costs…" of that capacity. (Issue Paper at 12). That approach is antithetical to the design of markets, including the CAISO's new market, and will not establish incentives for the development of efficient new resources to enter the market.

With respect to the CAISO's need for capacity to satisfy other system operating needs, J.P. Morgan recommends that the CAISO rely on either existing market products (Ancillary Services) or develop needed new products. Establishment of, and reliance on, market based products, will ensure the timely development of the resources the CAISO needs to reliably operate the system. To the extent the CAISO relies on other mechanisms, the CAISO must ensure that it fully compensates the resources, both with respect to the full amount of service (capacity) provided, but also at a price that permits the resources to cover its short-term costs (incremental and going forward fixed costs) as well as a contribution to its capital costs. In the end, J.P. Morgan recommends establishing different prices for different capacity services. The capacity products the CAISO contemplates procuring under its CPM are not the same and therefore should not be priced the same.

In addition, J.P. Morgan recommends that the CAISO establish location-specific prices for capacity. Such locational prices should complement the CAISO's LMP market design and will create appropriate incentives for developing resources in needed areas. The establishment of location-specific prices is consistent with the larger RA program, wherein the CPUC and CAISO require load-serving entities to procure RA capacity in specific quantities in specific local areas of the system. As referenced in the Issue Paper, the CAISO previously considered development of locational capacity prices through the development of a "market-proxy price derived from an administrative capacity demand curve and a price floor." (Issue Paper at 12). The CAISO should once again consider that approach in order to establish locational relevant prices that attract new investment in appropriate technologies.

3. Please provide your thoughts on the ISO's suggestion to broaden ICPM procurement authority through creation of a new category that would allow the ISO to procure capacity for up to 12 months in order to make resources with operational characteristics that are needed to reliably operate the electric grid available to the ISO.

J.P. Morgan understands the CAISO's desire to broaden its CPM procurement authority to permit it to procure capacity needed to address its system operating requirements. Consistent with the comments it previously submitted regarding the CAISO's Exceptional Dispatch authority, J.P. Morgan supports CAISO efforts to 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. Moreover, 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. Absent clear identification of those requirements, and either 1) development of new or use of existing market products; or 2) refinement of the CPUC's LTPP and RA requirements, the CAISO is forced to rely on backstop mechanism like the CPM. As noted above, while J.P. Morgan is not opposed to the CAISO expanding its CPM procurement authority to obtain resources with the necessary operational characteristics, such authority should sunset after a limited specific period. Concurrent with this process, the CAISO should: 1) pursue specification and development of the new services/products necessary to satisfy its operational needs in its upcoming renewable integration/ancillary service review effort; and 2) actively participate in the CPUC's new LTPP to specify its operating needs and help guide appropriate, i.e., "best fit", procurement by load-serving entities.

4. Please provide your thoughts on the ISO's suggestion to modify the criteria that would be used for choosing a resource to procure under ICPM from among various eligible resources so that it recognizes characteristics such as dispatchability and other operational characteristics that enhance reliable operations.

See answer to (3) above regarding general concerns with this approach. J.P. Morgan is not opposed to the CAISO modifying the criteria that would be used for choosing a resource to procure under CPM from among various eligible resources. However, such criteria must be clearly detailed and must be applied in a non-discriminatory manner.

5. Please provide your thoughts on the appropriate treatment of resources that may be procured through Exceptional Dispatch but then go out on Planned Outage during the period for which the resource has been procured. If you have a specific proposal, please provide it and indicate the reasons for your proposal.

The CAISO Issue Paper outlines two options for addressing this issue: (1) to pay the CPM resource the CPM compensation for the minimum of 30-days or the number of days between the Exceptional Dispatch and the start of the scheduled outage, and (2) allow the resource to provide equivalent substitute capacity from another resource for the days when the Exceptional Dispatch resource is out of service. J.P. Morgan believes that the above options are workable and agrees that the options are not mutually exclusive. J.P. Morgan recommends that the above options be included on a menu of options. In addition, while it appears this was contemplated in the Issue Paper, the CAISO should offer a resource the explicit option of rescheduling its planned outage.

6. If you would like to identify other issues that you believe should be discussed in this stakeholder initiative, please discuss those issues here.

J.P. Morgan recommends that the CAISO reconsider the issue re minimum CPM designations. Under the existing rules, the CAISO can designate a resource at its P-Min or for an incremental amount of capacity between its P-Min and P-Max., even though potentially the entire capacity of the resource is available to the CAISO. While J.P. Morgan understands that this issue was previously discussed and contested at FERC, J.P. Morgan recommends that this issue be reconsidered in this process.

<u>Exceptional Dispatch</u>

7. Please provide your thoughts on what fair compensation is for non-Resource Adequacy, Reliability Must-Run Contract or ICPM capacity that is Exceptionally Dispatched.

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.

8. Please provide your thoughts on whether energy bids for resources dispatched under Exceptional Dispatch should continue to be mitigated under certain circumstances. If you have a specific proposal, please provide it, and indicate the reasons for your proposal.

J.P. Morgan recommends that resources Exceptionally Dispatched for energy only be mitigated in circumstances where they can reasonably foresee the need for their resource in order to address a CAISO need. 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.

9. Please provide your thoughts on whether to change the categories of bids subject to mitigation under Exceptional Dispatch (Targeted, Limited and FERC Approved) and whether to extend the bid mitigation for the existing categories.

See answer to (8) above.

10. If you would like to identify other issues that you believe should be discussed in this stakeholder initiative, please discuss those issues here.

<u>Other</u>

11. Please provide any additional comments regarding any other topic that your want to address.