CAISO Governing Board Members: December 11, 2012

First, on behalf of Calpine, let me wish you and your families a happy and restful holiday and a wonderful new year.

I take the uncommon step of sending this advance note to highlight the importance of what might otherwise seem to be an innocuous decision item in front of you this Friday.

In Calpine's view, Item 5 is nothing more than an energy Price Cap (although it is fully described as the "Transmission Constraint Relaxation Parameter Modification"). This proposal allows the CAISO to use out-of-market solutions, explicitly including Exceptional Dispatch, if the price to resolve congestion rises above $1,500. Calpine objects to this proposal on many fronts.

The proposal is motivated by a recent escalation in costs to resolve infrequent, but significant real-time congestion. The causes of this cost escalation are described in the CAISO documents as related to situational drivers and structural drivers. The situational drivers include the fact that transmission is tight because of the SONGs outage and certain fires. Calpine believes that these situations should, and for proper transmission of price signals, must be, reflected in LMPs. The structural drivers are due to long-standing differences between DA and RT markets (including the impact of unscheduled flows.) The CAISO is focused on (e.g., imposing an import margin (TRM) in the DA market to estimate RT unscheduled flows), and should be focused on correcting these structural drivers rather than cutting otherwise important price signals.

The CAISO's analysis suggests that if the price cap had been in operation in the 3 months from August to October, it would have cut $25 million of revenues from generation beneficially-located in constrained load pockets. LMPs would have been (and will be if the proposal is approved) suppressed in the particular areas where we most need price signals.

The CAISO claims that there is a law of diminishing returns at play – and while Calpine was sensitive to that issue, the analysis of CAISO does not support the conclusion. Specifically, in order to draw their conclusion, the CAISO looked at a mere 13 instances of high 5-minute prices over the last 6 months. Just to be clear, that is 13 out of about 40,000 intervals. Indeed, in those cases, little relief to the constraint occurred at prices over $1,500. They say nothing about the other 99.97 percent of the intervals in which some, or even substantial relief may have occurred at prices above $1,500. Indeed, two of the three intervals initially reviewed did show congestion relief at prices above $1500. These intervals were not included in the Final Draft Proposal.

With implementation of the price cap, the CAISO also proposes to use out-of-market actions to ensure a secure grid. They suggest the use of (likely) pre-emptive Exceptional Dispatch and other actions should the price rise or be expected to rise above the cap. Pre-emptive Exceptional Dispatch places unpriced energy into the real time market which would have suppressive effect on all LMPs. Both FERC and most recently, the CAISO's MSC have voiced significant concern over the consistent and even growing use of Exceptional Dispatch.

Specifically, in its decision on October 26, FERC said:

> "CAISO's Filing suggests that its use of Exceptional Dispatch may be too expansive."
> And

"…we note that we are concerned with the extent if CAISO's reliance on out-of-market solutions, which tend to artificially depress market prices."

And just last week, the MSC said:

"We are concerned with the continuing high levels of exceptional dispatch, and particularly the relative lack of information concerning their causes and effects."

Calpine strongly believes that at this point in time, the Board should not be encouraging the expanded use of Exceptional Dispatch (or other forms of out-of-market intervention).

Rather than simply and conveniently setting a lower price cap, the CAISO should undertake the following:

- Allow the CAISO modifications (e.g., TRM modifications) to demonstrate their effectiveness
- Revisit alternatives to the lower price cap such as modifying the minimum or relative effectiveness factors for units dispatched to manage congestion.
- Focus on and resolve ongoing structural issues driving RT congestion costs
- Finally, if the Board approves the price cap, establish a sunset of one year.

Thank you for your consideration of our comments.

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