Stakeholder Comments Template

Subject: Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch

Submitted by	Company	Date Submitted
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This template was created to help stakeholders structure their written comments on topics related to the July 15, 2010 Straw Proposal for Capacity Procurement Mechanism ("CPM"), and Compensation and Bid Mitigation for Exceptional Dispatch. Please submit comments (in MS Word) to bmcallister@caiso.com no later than the close of business on July 30, 2010.

Please add your comments where indicated responding to the topic or question raised. Your comments on any aspect of the straw proposal are welcome. The comments received will assist the ISO with the development of the Draft Final Proposal.

Please provide your comments on the following topics and questions. Your comments will be most useful if you provide the reasons and the business case for your preferred approaches to these topics.

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.

   SCE supports maintaining the current overall (I)CPM structure without a specific termination date. However, the CAISO should draft its CPM proposal in a manner that would allow it to have the ability to update certain elements of the CPM on a periodic basis (e.g., have mechanisms to update the price paid for backstop procured capacity if the assumptions upon which the payment is based change significantly).

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?

   SCE agrees with the CAISO that the CPM rules should be clarified to address this situation. SCE supports the ISO's proposal to either (1) allow a resource on outage to provide substitute capacity to cover the planned outage period in order to receive full CPM payment, or (2) simply prorate the CPM payment based on the number of days the resource is not on a planned outage for the CPM contract period.

   SCE also asks for clarification if these options are mutually exclusive or could they overlap, i.e. may a substitution occur for only part of a planned maintenance period? This situation would then entail substitution as well as prorated compensation.

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.

   SCE agrees that if all other factors are the same, it would make sense to procure capacity from a non-use limited resources over use-limited resources. However, this should be a "tie-breaker" not part of the reliability selection criteria. SCE supports a process whereby the combination of CPM payments and/or SCP charges compensates resources for the actual capacity provided to the market.

   Additionally, SCE would like clarification on what the CAISO is referring to as a use-limited resource. Currently CAISO uses the use-limited flag in the master file to capture both use-limited resources (like gas turbines with emissions constraints) and non-dispatchable resources (like nuclear plants). Does the CAISO plan to limit their preference to only use-limited resources or both use-limited and non-dispatchable resources?

4. The three new types of procurement authority for generic backstop capacity the ISO is proposing.
   a. Procure generic capacity to allow planned maintenance to occur. This approach is preferred to the current approach which is to issue an Exceptional Dispatch.
   b. Procure generic capacity to backstop observed less-than-planned output from intermittent resources, i.e., when the ISO notices that intermittent resources are not performing up to their RA value; and
   c. Procure generic capacity of resources that are needed for reliability that are in danger of shutting down due to lack of sufficient revenues. Note that these resources would be eligible for capacity payment up to 12 months in a year.

Question 4a - Procure generic capacity to allow planned maintenance to occur. This approach is preferred to the current approach which is to issue an Exceptional Dispatch

The California Public Utilities Commission ("CPUC") through its Resource Adequacy ("RA") program has already established rules that account for planned outages. These rules ensure that sufficient capacity remains available to the CAISO to maintain grid reliability by prohibiting LSEs from counting RA Resources that are on planned outages for a certain duration. Consequently, it would be inappropriate and duplicative for the CAISO to also require additional capacity procurement for the sole purpose of allowing generators to take planned outages. Further, the CAISO has the ability to reject any request for a planned outage that, based on its own assessment, will jeopardize grid reliability.

In addition, during the July 22 web-conference/stakeholder discussion, the CAISO indicated that there are certain infrequent circumstances, mainly related to out-of-service transmission lines that require the CAISO to issue an Exceptional Dispatch in order to maintain grid reliability. The CAISO proposes to end Exceptional Dispatch for such reasons in favor of using the CPM to procure additional capacity. However, the CAISO has not sufficiently elaborated on these circumstances. To the extent the CAISO can identify and narrowly define these situations, SCE would then consider supporting the CAISO's proposal. Absent an elaboration of the special circumstances that require procurement of additional capacity for planned outages through CPM that is above and beyond the CPUC requirement, SCE believes that the current RA rules combined with the CAISO's ability to reject planned outage requests provides adequate certainty that the CAISO will have sufficient available capacity to maintain grid reliability during planned outages.

Question 4b - Procure generic capacity to backstop observed less-than-planned output from intermittent resources, i.e., when the ISO notices that intermittent resources are not performing up to their RA value.

SCE does not support the CAISO's proposal to procure generic capacity to backstop less-than-planned output from intermittent resources. RA counting rules are within the jurisdiction of the Local Regulatory Authority. In the case of the CPUC, counting rules for intermittent resources have already been established using an "exceedance" methodology. Indeed, the CAISO was instrumental in getting this new methodology adopted to more accurately reflect the contribution of wind and solar resources during peak hours when the capacity is needed most.

In addition, assuming FERC approval of the CAISO's Standard Capacity Product ("SCP") II initiative, wind, solar and other non-dispatchable resources will soon be subject to the SCP tariff and its availability standards.

The CAISO's proposal to backstop procure generic capacity for observed less-than-planned output from intermittent resources will undermine the CPUC's ability to determine RA counting rules. Moreover, the CAISO's proposal unnecessarily circumvents its proposed SCP II tariff provisions, which already apply availability incentives and non-availability charges for intermittent resources. Accordingly, the CAISO does not need to procure additional capacity for intermittent resources, and can rely on the CPUC's counting rules and its own SCP availability provisions.

Question 4c: Procure generic capacity of resources that are needed for reliability that are in danger of shutting down due to lack of sufficient revenues. Note that these resources would be eligible for capacity payment up to 12 months in a year.

It is SCE's position that in order for the CAISO to procure backstop capacity, the CAISO must first have clear criteria defining its reliability needs (e.g., Local Capacity Requirements) and also ensure, in coordination with Local Regulatory Authority (i.e., the CPUC for SCE), that there is a process in place that allows LSEs to procure their share of any clearly defined reliability need before the CAISO procures via a backstop mechanism. The CAISO's proposal in 4c does not meet either of these criteria.

In addition to not meeting these two criteria, there are several issues with CAISO's proposal. First, it is unclear what reliability need is not being met because a generator doesn't have sufficient revenues to continue operation. Why has the CAISO not met its reliability need via the RA process? Second, it is not clear how the CAISO would determine that a generator does not have sufficient revenues to continue operation (or even why the CAISO should be the entity making this decision). Would a generator have to file with the CAISO for a revenue deficiency determination? How would entities be able to appeal the CAISO's decision if they do not agree? Third, it is not clear why the CAISO's current mechanisms – CPM extended for RA/Local RA backstop and RMR – would not be sufficient to address its reliability needs. Finally, assuming the CAISO could determine that it needs a resource that was in danger of shutting down due to lack of revenues for a specific reliability need, it is unclear how the CAISO's decision would be integrated into the CPUC's regulatory processes such as LTPP, where generation needs to meet the state's policy goals are being considered (e.g., once-through cooling phase out, renewable integration). It would not be an acceptable outcome for the CPUC's process to determine that a given generator is not needed to meet state policy objectives, only to have the CAISO backstop that generator because it believes the generator is not receiving sufficient revenues to continue operation. SCE urges the CAISO to eliminate this proposed procurement option and instead focus on a more targeted CPM mechanism that is linked to specific reliability requirements in coordination with LRA procurement proceedings.

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.

   SCE continues to support Option B (going forward costs) for use in CPM. The dominant consideration in favor of a going-forward costs approach (as opposed to a cost-of-new-entry, or CONE approach) is the timing of when the CAISO awards CPM contracts. At most, the CAISO awards CPM contracts only a few months prior to the delivery period. More typically, the CAISO will award the CPM contract just prior to or during the delivery month. As a result, these contracts only secure existing capacity. The CPM lacks key features that a mechanism to drive new entry needs. Simply adopting a CONE payment will only result in inappropriate cost to customers. As such, the CAISO should base CPM payments on going-forward costs needed for existing units to remain operable during the time required by the CAISO. In the event the "standard" CPM is insufficient to cover these going forward cost, the CAISO proposal allows individuals to make a separate showing, based on actual going-forward costs, to FERC to ensure they are adequately compensated.

   With respect to the CONE approach, SCE supported this concept as part of a centralized capacity market. However, that support was in the context of a capacity market that clears several years (4 to 5) prior to the delivery period. This time lag was crucial to SCE's support in that a market run far enough in advance allows new entrants to compete with existing resources. It also provides enough time for the construction of new resources. Moreover, the design SCE supported provided new resources with the option to obtain 10-year capacity payments with price certainty. In summary, this design (1) allowed new entrants to compete against incumbents; (2) allowed enough time for new resources to be built (4+years); and (3) provided a certain capacity revenue stream that would facilitate the financing needed to make the project commercially viable. In contrast, the CPM provides neither the time horizon nor the financial certainty needed to support new entry. Simply put, CPM will not drive or support new entry; thus, a CONE payment would be inappropriate.

   Moreover, there are several problems with the CONE approach. First, it is unclear how the CAISO will establish the "supply" input used to determine the CPM price. Not only must the CAISO consider existing supply, it must make assumptions on retirements, and levels of demand response. Second, the CAISO will need to determine separate locational values under the proposal. Finally, the subtractor for "peak energy rents" requires further definition. Collectively, the CAISO would have to either determine these values ex-post (in which case the market would not know what the CPM value actually is until after the delivery year is over) or estimate ex-ante (in which case errors in estimates

could potentially distort the broader bilateral capacity markets). Furthermore, CONE is simply a price for "generic capacity" when in fact the CAISO seems to be moving in a direction in which attribute-associated capacity will be required in the near future. While not necessarily insurmountable, these difficulties make it premature to move to a CONE approach in this venue. The CAISO has a relatively tight time-line to get the CPM in place, and it will be difficult, if not impossible, to debate and properly resolve the technical details of a CONE approach in this timeframe, especially given the linkage of "attribute" requirements versus generic capacity, move RA procurement to a forward basis, and coordinate such changes with the CPUC (especially given that so far the CPUC has been unwilling to move RA procurement to multi-year forward basis) .

In conclusion, CPM contracts will only be available for existing resources and will not drive new construction. As a result, payments should focus on paying going-forward costs, not cost-of-new entry. While SCE supported a cost-of-new entry design as part of a forward capacity market, until and unless the CAISO changes the overall construct of CPM and the RA process (in coordination with the CPUC) to be a multi-year forward process, CONE is not appropriate for CPM. Moreover, such a comprehensive redesign of CPM is not possible given the time restrictions the CAISO is under to replace CPM. As such, the CAISO should model the CPM process, including payments, after the existing ICPM process with some flexibility to modify parameters going forward.

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

SCE does not support the CAISO broadening its backstop procurement authority to procure capacity from resources that have certain operational characteristics within this stakeholder initiative. If the CAISO develops this process in isolation from the CPUC's RA procurement process and the CAISO Renewable Integration Market and Product Review initiative, this authority has the potential of completely changing the current RA structure. The proposal to procure backstop capacity with certain operational characteristics presents many issues that need to be fully vetted and discussed with stakeholders, such as:

- Defining specific operational characteristics and determining procurement needs;
- Incorporating these operational characteristics upfront in the CPUC's RA process in order for LSEs' to control costs; and
- Grandfathering and determining resource qualification.

The CAISO should not move forward with this concept in this initiative. Instead, the CAISO should discuss these issues in the context of the overall RA rules and within the CAISO's Renewable Integration and Market and Product Review stakeholder initiative.

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?

   It is premature for the CAISO or stakeholders to determine the specific operational characteristics the CAISO should seek backstop procurement authority for until the CAISO completes its 20% and 33% renewable integration studies and clearly defines both the system needs and procurement targets it expects in the future.

   As stated in question 6, SCE believes this issue should be discussed in the context of the CPUC's RA rules and the CAISO's Renewable Integration Market and Product Review initiative stakeholder process.

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?

   It is premature for the CAISO or stakeholders to comment on specific compensation mechanisms for backstop procurement of non-generic capacity until the CAISO completes its 20% and 33% renewable integration studies and clearly defines both the specific system needs and procurement targets it expects in the future.

   As stated in question 6, SCE believes this issue should be discussed in the context of the CPUC's RA rules and the CAISO's Renewable Integration Market and Product Review initiative stakeholder process.

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?

   SCE concurs with the CAISO's proposal that energy bids of resources dispatched under Exceptional Dispatch should continue to be mitigated under certain circumstances, and such mitigation should reflect a continuation of the current bid mitigation practices.

   As was presented to and approved by FERC[1], the CAISO has sufficiently identified the importance of being able to mitigate energy bids when a resource

[1] Docket Nos. ER08-1178-000, EL08-88-000. FERC Order on Section 206 Investigation, Technical Conference, Accepting in Part and Rejecting in Part Tariff Provisions, and Implementing Transitional Measures (Issued February 20, 2009), Par. 74.

has the potential to exercise market power, and the CAISO has adequately shown that exceptional dispatches for the purpose of addressing reliability requirements related to non-competitive constraints or needed to address the Delta Dispatch are two situations when an exceptionally dispatched resource has the potential to exercise market power.

SCE believes that the current (in)abilities of the market software regarding this issue are comparable to the market software's (in)abilities that served as the basis for FERC's findings and as such SCE believes that the current exceptional dispatch bid mitigation practices should continue.

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?

   SCE does not see a need to add categories or extend the current bid mitigation practices associated with exceptional dispatch. While one cannot use past history regarding the need to mitigate bids associated with exceptional dispatch to definitively forecast future need to mitigate bids, the CAISO has characterized the number of exceptional dispatches subject to bid mitigation as a relatively low portion of all exceptional dispatches. SCE is not aware of any other exceptional dispatch categories which enable a resource to potentially exercise market power.

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?

   SCE supports the CAISO's proposal to continue compensating exceptional dispatch-based CPM-procured capacity based upon the compensation methodology applicable for generic CPM procured capacity. However, SCE's support is based upon the qualification that the current exceptional dispatch-based ICPM compensation methodology is based upon going forward fixed costs (along with the opportunity for resources to cost justify higher going-forward costs). As stated by FERC, capacity procurement mechanisms are for procuring capacity for short periods to meet system reliability needs and, therefore, are not designed to encourage new investment[2]. FERC's decision included review of and rejection of requests to base compensation of backstop procured capacity on the cost of new entry[3].

[2] Docket Nos. ER08-556-000, ER06-615-020. FERC Order Accepting Tariff Filing Subject to Modification (Issued October 16, 2008), Par. 41.
[3] Ibid, Par. 42.

Other

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

Schedule:
While SCE believes that the CAISO should continue the fundamental ICPM methodology on a permanent going-forward basis, to the extent the CAISO is determined to broaden its procurement discretion to include operational characteristics or any of the other proposals listed in the straw proposal, then the CAISO should establish a more robust stakeholder process that allows adequate time for workshops and other activities to thoroughly consider the impacts to policy, necessity, and implementation before moving forward. One of the many topics to discuss during a more robust stakeholder process would be the potential need for the CAISO to consider generator-specific, cost-based compensation in certain circumstances when backstop procurement is needed to address a clearly defined reliability need for twelve months.