



California ISO
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**Stakeholder Written Comments on
CAISO May 9, 2007 Issues Paper on
Interim Capacity Procurement Mechanism**

**California Independent System Operator
Market & Product Development Group
May 30, 2007**

Stakeholder Written Comments on CAISO May 9, 2007 Issues Paper on Interim Capacity Procurement Mechanism

Introduction

The California Independent System Operator (“CAISO”) posted an issues paper on May 9, 2007 to facilitate discussion at a stakeholder meeting that was held on May 18, 2007. The issue paper presents a general strategy for developing an interim capacity procurement mechanism and describes many of the topics that will need to be discussed to reach a final proposal. The CAISO anticipates revising the May 9, 2007 issues paper or creating a more robust “white paper” after the May 18, 2007 meeting that incorporates stakeholder comments and reflects progress toward a fully developed replacement for the current Reliability Capacity Services Tariff (“RCST”).

Prior to the posting of the May 9, 2007 issues paper, the CAISO talked informally with a broad range of stakeholders to better understand issues from the stakeholder’s perspective. Their feedback is included in a separate section of the issues paper.

Formal written comments from stakeholders were due on May 25, 2007. The CAISO has posted the received written comments. In their written comments, stakeholders were asked to describe whether all of the essential topics have been captured, and suggest approaches to resolve such topics as well as any other topics that stakeholders have identified. Given the interaction among the components of the interim capacity procurement mechanism, such as the trigger for designating a resource, the term over which payment would be made, the price that would be paid for capacity, and the allocation of costs, it was requested that suggested approaches address the full set of elements and their interaction.

Written Comments from Stakeholders

The written comments that were provided to the CAISO by stakeholders following the May 18, 2007 stakeholder meeting are copied below.

Reliant Energy Inc.'s Reliability Backstop Proposal Comments Regarding the CAISO Whitepaper

The Resource Adequacy Requirements of the CPUC are currently the first line of offense to ensure that the CAISO has sufficient capacity to meet its reliability needs. A proper backstop mechanism should be rarely used in light of the CPUC's Resource Adequacy ("RA") program but, if it is, should support and not interfere with forward contracting of RA capacity. Arbitrary pricing and after-the-fact designations (i.e., after an event or events have occurred) fail to achieve the goal.

The CAISO will need to file at FERC a replacement backstop mechanism to be effective January 1, 2008 – to align with the cessation of existing RCST provisions and to support the CPUC's 2007 RA showings for calendar year 2008. The CAISO could first procure any necessary backstop capacity in advance of January 1, 2008 after the LSEs announce their RA plans. The CAISO would also be able to procure backstop capacity, if needed, during the calendar year 2008 and thereafter until a centrally-cleared capacity market is implemented. Any designations during a calendar year should also be based on the CAISO's expected balance of loads and resources for the system and local areas. With this approach, the CAISO arranges adequate capacity to meet and withstand the new forecasted conditions and potential contingencies.

Reliant supports the replacement of the existing RCST mechanism with one that fixes the most significant of identified deficiencies.¹ The replacement should serve as a Resource Adequacy Backstop Service Tariff ("RABST").

Generator compensation for the RABST should be based on a real proxy generating unit and not a hypothetical unit with theoretical operating characteristics. For example, the utility-build peaking units currently under construction in California at this time could serve as the basis for the real proxy unit for purposes of pricing the RABST. Generating units that the CAISO procures under the replacement backstop should be paid a price based on the annual levelized cost per megawatt of the last generating unit of capacity added to the relevant region. Since no supplier can demand more than the proxy value of backstop capacity no supplier is able to exercise market power.

RABST designations should be for one year. A generating unit designated at any time after the start of a calendar year, such as mid-year, should be paid the annual value of

¹ Among the deficiencies of the current RCST, as it is being implemented by the CAISO, are:

1. Proxy values of capacity that do not reflect the real, and demonstrable, cost of installing the last generating unit of capacity in the relevant region and that, in turn, interfere with forward bilateral capacity markets.
2. Failure to commit needed resources on a forward basis that are not procured as part of the existing CPUC Resource Adequacy program.
3. Fractional after-the-fact payments, instead of forward term payments, for capacity.
4. Ambiguous designation procedures that might be, at best, applied sometime after one or a number of reliability events have occurred.
5. Generating unit availability metrics that are inconsistent with existing CPUC Resource Adequacy criteria.

the real proxy unit and not some portion thereof since the real proxy unit's annual costs are not pro-rated.

RABST is not a call option but, rather, capacity that is required to schedule or offer energy or ancillary services for the term of the designation and should be treated equally with RA resources under the CAISO tariff. The performance/availability criteria should be consistent with the CPUC's 12/31/05 guidance memorandum regarding LSE Resource Adequacy Requirement (page 6 of memorandum). The guidance memorandum sets forth the following criteria:

Summer (May through September). Any month where days of scheduled outages exceed 25% of days in the month, the resource does not count for RA. If scheduled outages are less than or equal to 25% the resource does count for RA.

Non-Summer Months (October through April): For scheduled outages less than 1 week, the resource counts for RA. For scheduled outages 1 week to 2 weeks, the amount counted for RA is pro-rated using the formula:

$$[1 - (\text{days of scheduled outage} / \text{days in month}) - 0.25] * MW = RAR.$$

The formula will allow resources to count between 50% and 25%. For scheduled outages over 2 weeks, the resource does not count for RA.

In addition, generating units should not be penalized twice for unforced outages, e.g., during the performance year through a payment reduction and in the following year as an adjustment to EFORd/UCAP.

The RABST can serve as the successor backstop mechanism in the CAISO's transition away from RMR commitments. However, the overhaul of the existing RMR processes should occur on a separate and parallel path with the development and implementation of the RABST. RMR is currently a component of CAISO's market power mitigation and, as discussed herein, RABST can serve as the successor mechanism in combination with the other components of CAISO market power mitigation.

Williams Power Company, Inc.
Comments on May 9, 2007 CAISO Interim Capacity Procurement Mechanism Paper
and May 18, 2007 Meeting
May 25, 2007

Williams Power Company, Inc. ("Williams") thanks the CAISO for the opportunity to provide these comments in regards to the CAISO's May 9, 2007 Issues Paper for a Tariff Filing for Interim Capacity Procurement Mechanism and the May 18, 2007 meeting on the same matter.

1. The CAISO should eliminate RMR service in 2008.

As a market facilitator (but not market participant), the CAISO's fundamental role in California's Resource Adequacy program should be to identify the amount of capacity required throughout the CAISO control area and in various smaller regions to enable the CAISO to meet reliability requirements. The CAISO should itself procure needed capacity only as a last resort and should avoid creating procurement mechanisms which may discourage market participants from securing adequate contracts to meet these capacity obligations themselves.

In this light, Williams sees no reason why the CAISO intends to retain RMR contracts for 2008.

- Having two capacity backstop mechanisms – RMR and the new (yet-to-be-defined) interim mechanism – is unnecessary. The CAISO is sensibly seeking to address a long-standing problem, namely, the difference between the RMR designation criteria and the criteria by which it actually operates the system (now, the Local Capacity Requirements criteria) – by dropping the RMR criteria and adopting only the LCR criteria. The CAISO should similarly seek to retain only one capacity procurement mechanism.
- The RMR contract provides only local service and is not suitable for meeting system capacity requirements (despite the bewildering fact that capacity from Condition 2 RMR units, which cannot be dispatched for system needs, is allocated to meet system-wide RA requirements).
- There is no need to retain RMR contracts merely to procure certain ancillary services, such as voltage support, dual fuel and black start service.
 - First, on September 30, 2005, FERC directed the CAISO to develop a plan for the competitive procurement of these services. In response, on January 30, 2006, the CAISO filed this plan with FERC:

Date:	Policy Resolution Activities:
Complete by June 30 th 2006	Development of proposed conceptual design for the competitive procurement of Black Start and Voltage Support with stakeholder input.
Complete by September 30 th 2006	Presentation of initial white paper detailing the CAISO proposal – solicitation of stakeholder comments.
Complete by December 30 th 2006	Presentation of revised White Paper.
Complete by March 30 th 2007	Final policy resolution.

Minimal Software Changes Necessary Implementation in 2008

- March 30th to September 30th 2007: Procurement for 2008

Comprehensive Software Changes Necessary Implementation in 2009

- Complete by September 30th 2007: Detailed Design Specification (DDS)
- Complete by March 30th 2008: Software Development and Factory Acceptance Testing (FAT)
- Complete by June 30th 2008: Site Acceptance Testing (SAT) and final Quality Assurance
- Complete by September 30th 2008 for 2009: Production Software Deployment

To Williams' knowledge, the last action the CAISO took on this matter was to hold a conference call on June 29, 2006. Given that the CAISO is under an order to investigate ways to competitively procure these services, continuing to procure them under the RMR contract, while expedient, is opposite to FERC's clear mandate.

- Second, given that the nature of these services is already defined, there is no reason why these services could not be included in the interim capacity procurement mechanism until the CAISO has implemented a means to procure these services through competitive means.
- RMR contracts, which are priced based on the depreciated book value of the asset according to the former IOU owners, do not send the proper price signal regarding the value of capacity in locally constrained areas. The ability to have prices that reflect all network constraints – and, thus, encourage new investment where it is most needed – is one of the key reasons for moving to Locational Marginal Pricing.
- With the CPUC's RA program and local capacity requirements in place, the continued existence of over 3,300 MW of RMR contracts for 2007 could be explained by one of several reasons:
 - Local Capacity Requirements are not accurately determined.

- LSEs have not effectively procured those requirements.
- The CAISO requires black start service from those RMR units.
- The CAISO requires voltage support from those RMR units.
- The CAISO requires dual fuel capability from those RMR units.

Williams respectfully requests, to make clear the reasons why the CAISO still requires RMR service, the CAISO disclose, in aggregate, the current amount of RMR procurement relevant to each of the five bullets above.

2. The current RCST settlement provisions should not be extended beyond 2007 without significant reforms.

The RCST settlement was rushed to be in place by June 1, 2006, the commencement of the CPUC's RA program. The RCST settlement was designed to expire on the earlier of the implementation of MRTU (then scheduled for November 1, 2007) or December 31, 2007. Parties that opposed terms of the RCST settlement were supposed to be consoled by the certainty that RCST would be short-lived. Now, more than a year after the RCST settlement with its known sunset date was filed at FERC, the CAISO has begun a process to define RCST replacement, which, by its compressed and accelerated timeline, seems predestined to the conclusion that there is only enough time for one option, namely, to extend the current RCST settlement. Further, as the CAISO proposes, if the current process to design the replacement interim capacity mechanism falters, the contingency option is already defined - to continue with RMR service. Williams finds neither option - extension of RCST in its current form, or continuation of the RMR contract - acceptable.

Williams believes that the general framework of the RCST settlement - a tariff-based mechanism which the CAISO can designate in advance based on the cost of new entry with an ex ante peak energy rent deduction - is a reasonable platform on which to build an interim capacity mechanism. However, as discussed in pleadings filed at FERC, Williams opposes several provisions of the current RCST settlement and strongly opposes continuing the RCST settlement in its present form.

Should the CAISO determine that a continuation of RCST - in some form - is the only achievable option with respect to an interim capacity mechanism, Williams believes the following things, at a minimum, must be addressed for the RCST settlement framework to serve as the foundation for the new interim capacity mechanism:

1. The \$73/kW-year negotiated RCST settlement price must be replaced by a price that reflects the cost of new capacity construction of a real unit in California.
2. The peak energy/ancillary services rent deduction must be based on the actual operating characteristics of the real unit chosen to benchmark the price. If non-spin revenues are to be deducted, the benchmark unit must be capable of starting, synchronizing and fully loading in ten minutes, and the payment must fall within a zone that reflects the cost of units that can provide this type of service.

3. Given that the CPUC has concluded that capacity is an annual product, the CAISO should preferably forward designate capacity service for a year's term (as is done with RMR service), or, upon using any undesignated capacity for any reason, provide designation of that capacity for the next twelve months.

In 2006, the CAISO took over 80 unit-days of reliability service from un-contracted units to which Williams has exclusive output rights without – to date – designating any of these units as RCST. Williams estimates that the RCST payment that results from this day-today provision of critical reliability service will only be marginally higher than the payments such units would have received under the former MOO compensation, which FERC has already determined to be unjust and unreasonable. And, indeed, Williams estimates that one unit in particular, which was must-offered 28 times during the June-July 2006 period, stands to receive *no* RCST payment in excess of the former MOO compensation methodology unless such unit ultimately receives a designation for 2006. That is, Williams estimates that this unit stands to receive nothing above the rate that FERC has already concluded is unjust and unreasonable because such former rate fails to adequately compensate must-offer generators for the reliability services they provide. In sum, it is unreasonable for the CAISO to rely on uncommitted units with no assured revenue streams in price-capped markets to provide reliability service at any time for a daily rate that, for at least one unit, has already been determined to be unjust and unreasonable.

Preliminary Comments on CAISO Backstop Procurement California Municipal Utilities Association (“CMUA”)

Pursuant to the procedures outlined by the CAISO, CMUA submits these Preliminary Comments on CAISO’s “Issues Paper: Tariff Filing for Interim Capacity Procurement Mechanism.” CMUA appreciates the opportunity to work with the CAISO and stakeholders to resolve issues raised in the Paper. CMUA considers all issues surrounding CAISO backstop procurement as “open” for discussion, and urges the CAISO confirm this, in order to maximize the possibility for a global resolution to this matter on the schedule contemplated by the CAISO.

Setting Boundaries on CAISO Procurement

In General

The CAISO states that “to reliably operate the system and serve Load, the CAISO must have sufficient capacity made available to it.” Issues Paper at 3. This is a truism. This statement is not synonymous with “to reliably operate the system and serve Load, the CAISO must have available capacity that it determines is necessary in its sole and unfettered discretion.” The CAISO recognizes this at several points in its Issues Paper. See Issues Paper at 5-6 on “Significant Event.” One matter CMUA members will be examining closely is what assurances they will have that if they self-provide, they will minimize or eliminate any exposure to uplift costs. Also, CMUA urges the CAISO to look at Load, not just generation, as a solution to this problem. Load might be a solution with formalized use of Demand bidding. The CAISO should also recognize that many LSEs may have or can develop measures to shed Load that cannot be easily reflected in a bid-based approach to contingency response. These Load-based measures should be included in the CAISO’s consideration of its backstop procurement role.

Applicable Definitions and Relationship to Residual Unit Commitment

The CAISO states that the functions of the backstop procurement mechanism are: (1) to cover LSEs that are short as compared to their applicable RA requirement; (2) to enable operation of the CAISO Control Area and Controlled Grid in compliance with Applicable Reliability Criteria; and (3) to respond to a Significant Event. Issues Paper at 4.

Proper definitions are critical. The definition of Applicable Reliability Criteria in the MRTU Tariff is as follows: “The reliability requirements as established by NERC, WECC, and Local Reliability Criteria as amended from time to time, including any requirements of the NRC.” CAISO MRTU Tariff, Original Sheet No. 528. Local Reliability Criteria, in turn, means “Reliability Criteria unique to the transmission systems of each of the Participating TOs established the later of: (1) the CAISO Operations Date; or (2) the date upon which a New Participating TO places its facilities under the control of the CAISO.” CAISO MRTU Tariff, Superseding Original Sheet No. 560. This appears to be a reasonable place to start the discussion. CMUA interprets the definition of Applicable Reliability Criteria to be objective, i.e. required to be affirmatively established by NERC or WECC, and not within the CAISO discretion to amend. CMUA interprets Local Reliability Criteria to be legacy practices of PTOs, and not subject to further revision. CAISO requests confirmation of its understanding of these two definitions. Also, CMUA requests information on where it may find and examine the Local Reliability Criteria, so that it may better understand what forms the basis for the CAISO’s proposed backstop capacity procurement.

On the definition of Significant Event, the CAISO acknowledged at the stakeholder meeting that this term required work and clarification.

The proposed backstop procurement is not the only mechanism under which the CAISO procures resources beyond the RA resources made available by LSEs. The IFM also includes an extensive and complex Residual Unit Commitment process. The Issues Paper recognizes the interaction of RUC and backstop procurement, both with respect to roles and pricing. See Issues Paper at 3-4, 6. CMUA understands that the purpose of backstop procurement is to make capacity payments to units that will be needed for extended periods of time. However, on Significant Event and other issues, there is clearly the potential for RUC and backstop procurement to overlap. The relationship between these two mechanisms requires further exploration.

The LCR Study

In General

It is no secret that CMUA members have concerns about the LCR Study that underlies the proposed LCR. It is not CMUA's intent to raise these concerns here in these Preliminary Comments. It is clear that these local requirements are proposed to apply to CMUA members under the MRTU Tariff, either through procurement requirements, or CAISO procurement cost allocation. CAISO MRTU Tariff, Section 40.3.2. This is in contrast to the CPUC proceedings in which CMUA has raised most of its objections to the LCR Study; the CPUC has not asserted jurisdiction, nor does it have jurisdiction, over CMUA member procurement practices. Now that the LCR Study forms the basis of Tariff-authorized action, it is imperative that some process be instituted by the CAISO to subject the LCR Study to scrutiny within the schedule outlined, prior to using the study to form the basis for procurement by the CAISO pursuant to Tariff authority. This process must include an effective ADR process to resolve disputes in the timeframe contemplated by the study process, so as to avoid potential refund issues that would involve all market participants if the CAISO commenced backstop procurement which was later found to be excessive, or would result in cost-shifts among Market Participants.

The Annual Local Requirement

The CPUC has determined to apply local capacity requirements over a 12 month period. The CAISO has supported this position at the CPUC. The arguments raised by the CAISO include: (1) the need to pay merchant generators their annual fixed costs, thus minimizing any potential benefit there may be to seasonal variation on the LCR based on actual reliability requirements; and (2) the increased need for generation and transmission coordination if there was a seasonal LCR.

There is a difference between the LCR Study, and the application of the identified local number on a 12 month basis. Clearly, requirements to meet load are lower in non-peak months, and the need for generation to be made available to meet Applicable Reliability Criteria is less if the transmission and generation maintenance done in the off-peak season is properly coordinated. To CMUA, increased coordination would appear to be a small price to pay to save available capacity costs. And, CMUA members believe there will be substantial cost saving. Much of their local capacity is owned by the utility itself, and the costs to make that capacity available over 12 months is significantly higher than making it available

seasonally. Also, there may be benefits, including benefits to facilitating use of Demand to meet LCRs, if backstop capacity costs properly reflected the seasonal variation of the requirement itself. Thus, replacing the annual requirement with a seasonal requirement may sharpen the price signals within the CAISO markets. CMUA urges the CAISO to facilitate a robust discussion of the annual LCR requirement. In the MRTU paradigm, it is no response to say “we must have an annual requirement because that is what the CPUC adopted.” The LCR has cost implications for non-CPUC jurisdictional entities under the 2008 CAISO Tariff, and must be considered as part of this process for 2008 procurement, and the required Tariff filing.

Coordination with Transmission Planning Criteria

CMUA members have observed shifting local reliability areas. The upshot of this is that even if CMUA members invest in local generation to meet local capacity requirements, that investment might not count toward local capacity requirements over the long term or medium term. This fact reveals that the true nature of the local capacity requirement is that there is insufficient transmission into a local reliability area to allow flexible response to identified contingencies.

Stakeholders at the initial meeting, including stakeholders that are PTOs and large LSE's, stated that transmission planning assumptions and CAISO operational practices are not aligned. This must be fixed if there is to be a durable solution that minimizes or eliminates CAISO backstop procurement. There is no time like the present; it should be fixed within this context of this effort rather than put off to another proceeding.

**Comments of Southern California Edison (SCE)
CAISO Backstop Capacity Product
May 25, 2007**

Summary

SCE appreciates the opportunity to provide comments on the CAISO's backstop capacity product. SCE supports the development of a backstop capacity procurement mechanism that can be in effect before the end of this year so that the CAISO can, if necessary, procure needed capacity based on clear and transparent criteria. We cannot rely on the current RMR contract for backstop procurement because the RMR cost allocation is inconsistent with today's Resources Adequacy structure. RMR costs are allocated to PTOs in whose service area the generator is located and this is fundamentally inconsistent with LSE-based RA requirements. The urgency of this backstop product effort is even greater if the CAISO's proposal to make the RMR criteria equal to the LCR Criteria is adopted by the CAISO Board.

As detailed below, we believe that we should utilize as much of the current RCST structure as possible, revising as necessary to be consistent with MRTU. SCE supports many of the preliminary positions provide by the CAISO in its May 18, 2007 stakeholder meeting presentation. A lot of debate has taken place to develop the current RCST mechanism, including a lot of give and take regarding obligations and compensation, and we should utilize as much of that mechanism as possible.

Trigger Mechanism

Under the current CAISO Tariff, RCST designation is triggered off of must-offer waiver denials (MOWDs). If a non-RA/non-RMR generator is denied a must-offer request for a sufficient number of times, a review process is triggered to determine if conditions warrant the generator being designated as an RCST resource. This approach fits well with the pre-MRTU market structure where even non-RA/non-RMR resources are subject to FERC's must-offer obligation. If a non-RA/non-RMR generator under a FERC must-offer obligation is consistently needed to reliability operate the grid, that generator should be eligible to receive just and reasonable compensation.

However, under MRTU, there will not be a must-offer obligation on non-RA/non-RMR resources. With a very limited exception, a must-offer waiver denial process is not provided for under the MRTU Tariff. In addition, non-RA/non-RMR generators are eligible for RUC availability payments based on voluntarily submitted bids into the CAISO's integrated forward market. Since non-RA/non-RMR generators aren't obligated to offer into the CAISO markets, and there is additional compensation available under MRTU for those non-RA/non-RMR generators that choose to offer, the current trigger mechanism based upon the must-offer waiver denial process is not appropriate for MRTU.

Under MRTU, SCE believes that there needs to be a forward looking trigger mechanism based upon LSE RA compliance filings and technical analysis of a "significant and enduring" event. SCE offers these suggested trigger mechanisms for consideration (we recognize that the implementation details would need to be developed).

Backstop capacity procurement shall be considered (not automatically occur) under the following conditions:

- 1) If an LSE is found to be deficient in meeting its System RA and/or Local RA obligation, the CAISO shall be permitted to determine whether or not it needs to backstop procure additional resources. Such a determination shall be based on the applicable criteria for System RA and Local RA. An LSE filing deficiency does not automatically trigger backstop procurement.
- 2) In the case where no LSE is deficient in meeting its System RA or Local RA obligation, but the CAISO identifies a local area reliability need because the aggregate LSE RA showings are not “effective” to meet the local requirement identified in the Local Capacity Study, the CAISO shall be permitted to backstop procure the most cost-effective resource(s) to meet the identified need.
- 3) If the CAISO determines that a “significant and enduring” event has occurred within its control area, the CAISO shall perform a technical analysis to determine if the CAISO can still meet System and Local RA criteria.
 - What is a “significant and enduring” event? A possible definition for consideration: A significant and enduring event is an unplanned outage of both transmission facilities and RA/RMR resources that 1) was not considered in the Local RA studies and 2) is expected to result in the CAISO not being able to meet Local RA criteria for a sustained period of time (e.g. weeks).

If a significant and enduring event occurred, the CAISO would be permitted (not automatic) to backstop procure generation to meet Local RA criteria. Market participants should be notified of the CAISO’s intent to backstop procure generation and the CAISO should also obtain CAISO Board approval before entering into a backstop procurement commitment.

Cost Allocation

In general, backstop procurement costs should be allocated to the entity that was deficient in meeting its System RA or Local RA obligation. Given the LSE-based RA requirements, it is inappropriate to allocate backstop procurement costs to PTOs, as is done for RMR cost allocation. PTOs do not file RA compliance filings and do not drive backstop procurement by the CAISO. Allocation of costs to PTOs would result in the PTO recovering those costs from transmission customers, many of whom would not have been served by the LSE who was deficient in meeting its RA obligation.

There may be some cases where all LSEs have met their RA obligations but the CAISO still needs to backstop procure a limited amount of capacity to meet a reliability need (e.g. to meet a Local RA requirement due to “effectiveness factors”). In such cases, the backstop procurement costs should be allocated to the Scheduling Coordinator (SC) for LSEs that had a Local RA obligation in the TAC area where the backstop procurement was required based on their load ratio share in the TAC area. For example, if an LSE has 10% of its load in PG&E’s TAC area, and the CAISO was required to procure 100 MW of backstop capacity in PG&E’s TAC area a Local RA requirement due to “effectiveness factors”, the SC for that LSE would be responsible for 10% of the backstop costs.

Finally, for significant and enduring events, costs should be allocated the same way they are under Section 43.8 of the current CAISO Tariff:

- “If the ISO makes any Significant Event RCST designations under Section 43.4 during 2007, the ISO will allocate the costs of such designations to all SC-RA Entities in the TAC Area(s) in which the Significant Event caused or threatened to cause a failure to meet Applicable Reliability Criteria based on Scheduling Coordinators’ 2007 RA Entity Load Share Percentage(s) in such TAC Area(s).”

Generator Compensation

Before discussing compensation, it is important to recognize how the generator would have ended up being eligible for backstop procurement by the CAISO. First, the generator would not have been identified as necessary to meet an RMR requirement (at least given the current RMR criteria and process). Second, the generator would not have been contracted by an LSE via a competitive procurement process to meet a System RA or Local RA requirement. Finally, the generator would not have elected to terminate its operations, presumably because it believed it would still be in its best interest to continue operations even without an RA or RMR agreement (e.g. make sufficient energy and RUC market revenues, sell to an LSE outside the CAISO control area, etc.). The situation under MRTU will be dramatically different than today where the generator is under a FERC must-offer obligation regardless of its business environment.

SCE agrees with the principle included in the CAISO’s May 18, 2007 presentation (slide #12): Once designated through the backstop mechanism, a resource would be treated like a Resource Adequacy resource. This means that once a resource is actually procured under the backstop mechanism, it would then have a daily offer obligation, an obligation to submit a \$0 availability bid in RUC (and not be eligible to receive a RUC availability payment), and would no longer be eligible for a Frequently Mitigated Bid Adder.

Some parties indicated at the May 18 meeting that they believe the generator capacity payment is too high (e.g. should be cost-based), and others believe it is too low (e.g. should be based on cost of a new peaker). SCE supports the compensation for generators that was accepted by FERC for the current RCST mechanism. The compensation mechanism, a capacity payment less peak energy rents, was appropriate given the burdens and benefits that were incorporated into the overall RCST settlement. Given the need to have a backstop capacity mechanism developed and filed with FERC by September, it would likely be challenging to begin to unravel the various trade-offs made that resulted in the current RCST compensation package.

SCE agrees with comments expressed at the stakeholder meeting that the expected duration of this backstop mechanism can have an impact on what parties may believe is an appropriate compensation level. However, suggestions that the backstop capacity payment should be based upon the cost of emergency peaker resources are completely unacceptable.

Role of RMR

It is SCE’s position that the CAISO cannot rely on the current RMR contract for backstop procurement because the cost allocation is inconsistent with today’s Resources Adequacy structure. RMR costs are allocated to PTOs in whose service area the generator is located and this is fundamentally inconsistent with LSE-based RA requirements. The need to develop an alternative backstop capacity product is even greater if the CAISO’s proposal to make the RMR criteria equal to the LCR Criteria is adopted by the CAISO Board.

SCE recognizes that some services, such as blackstart and dual-fuel capability, may need to continue to be procured via “RMR-like” contracts for an interim period. However, changing the RMR criteria to equal the LCR criteria is very problematic without a corresponding change to ensure that costs associated with such RMR backstop procurement are allocated to deficient LSEs or, in the case where there are no deficient LSE(s), to the SC(s) for the LSE(s) that had a Local RA obligation in the TAC area where the backstop procurement was required based on their load ratio share in the TAC area.

Duration of Product

Assuming the compensation and cost allocation under the current RCST mechanism remain in place for the backstop capacity product under MRTU, SCE generally supports the duration of the backstop procurement agreement presented in the CAISO’s May 18, 2007 stakeholder meeting presentation. The duration depends upon the reason for the backstop procurement, as described below:

- If the CAISO determines that it is necessary to backstop procure in order to address a deficiency in an LSE(s) year-ahead System RA showing, the backstop capacity commitment shall be for a minimum of 5 months (May-Sept). The maximum duration should be one year.
- If the CAISO determines that it is necessary to backstop procure in order to address a deficiency in an LSE(s) Local RA showing, the backstop procurement commitment shall be a calendar year (January through December).
- If the CAISO determines that it is necessary to backstop procure in order to address a deficiency in an LSE(s) month-ahead System RA showing, the backstop capacity commitment shall be for the balance of calendar year
- If the CAISO determines that it is necessary to backstop procure in order to address a significant and enduring event, the backstop capacity commitment shall be a minimum of 3 months and a maximum of up to the time that the CAISO determines that the event will remain in effect. Prior to entering the agreement, the CAISO should determine the maximum duration of the agreement (i.e. specify the expected duration of the event and limit the backstop commitment to that expected duration).

Do Non-RA/Non-RMR Generators Have An Obligation to Be Ready to Perform?

Unlike today’s CAISO tariff where generators under a PGA are under the FERC must-offer obligation, it is unclear if PGA generators are under any kind of offer obligation to be “ready to perform” if they are designated as a backstop capacity resources. It is our belief that backstop procurement designations under MRTU must be forward looking based on technical analysis – not backward looking based on historical performance like today. Based on that premise, suppose that a PGA generator does not have an RA or RMR contract. Further suppose that the generator does not plan to operate for the non-summer months. If a significant and enduring event occurs, and the CAISO identifies the resources as needed for backstop capacity from February through May, is the generator obligated to be ready to perform during that time period? SCE requests the CAISO clarify its understanding of the obligation of non-RA/non-RMR generators under a PGA to be ready to perform under MRTU.

**COMMENTS OF THE ALLIANCE FOR RETAIL ENERGY MARKETS
ON THE MAY 9, 2007 CAISO ISSUES PAPER ON
INTERIM CAPACITY PROCUREMENT MECHANISM
May 25, 2007**

The Alliance for Retail Energy Markets² (AReM) appreciates the opportunity to provide its initial comments on the CAISO's May 9, 2007 issue paper on the successor to the Reliability Capacity Services Tariff (RCST), referred to as the "Interim Capacity Procurement Mechanism." AReM has not had time to fully consider these issues. Therefore, these comments should be considered preliminary and subject to change.

A. General Principles

RCST as Framework for Successor – AReM is willing to consider using the current RCST mechanism as a framework for a successor under MRTU. AReM requests specific changes to the current RCST, as described below.

Term of RCST vs. Successor – AReM agrees with the CAISO's suggestion that the optimum solution would be to extend the current RCST settlement until MRTU is implemented and begin the successor arrangement concurrently with MRTU.

Term of Successor – AReM supports TURN's proposal made at the May 18th workshop to limit the term of the successor arrangement to three to four years. As TURN mentioned, the limited term should allow parties to reach agreement more readily, knowing that the issue is not set in stone for all time and will be revisited in a timely fashion. There are many unknowns about the evolution of the California market and the operation of MRTU and nodal pricing. The term limit will allow the CAISO and stakeholders to make any necessary adjustments to the successor arrangement within a few years.

Use of RMR – AReM has long urged the CAISO to get on with the business of establishing markets to procure specific products, such as black start and voltage support, needed for reliable operations, as FERC has ordered. Procuring these products under RMR agreements is far from the preferred approach. However, AReM believes that RMR contracts may continue to be needed in the event that market power is being exercised by a particular supplier. Accordingly, AReM does not agree with IEP and other suppliers that the successor to RCST *must* replace RMR as a fundamental principle.

Remedy for Exercise of Market Power – AReM expects the RCST successor to be market-based pricing. Condition 2 RMR contracts are cost-based and have been used as a remedy for market power by the CAISO. AReM questions whether it is appropriate to pay suppliers a market-based price when market power is or may be exercised. If it is not, the CAISO must propose a remedy for such situations.

Allocation of Costs – If a CPUC-jurisdictional load-serving entity (LSE) is meeting the CPUC Resource Adequacy (RA) requirements, there should be no capacity costs allocated to it, except for rare and unanticipated "Significant Events" (discussed below). If a non-CPUC jurisdictional LSE is meeting a reasonable RA requirement established by its

² AReM is a California non-profit mutual benefit corporation comprised of electric service providers that serve the majority of the state's direct access load. This filing represents the position of AReM, but not necessarily the view of any affiliates of its members with respect to any specific issue.

Local Regulatory Authority (LRA), there should be no capacity costs allocated to it, except for rare and unanticipated “Significant Events.”

B. Specific Details

RCST Framework Creates Potential for Subsidies – Under the RCST structure, as long as an LSE meets standards set by its LRA, then the CAISO can not allocate RCST procurement costs directly to that LSE. There is no requirement, however, that the standard set by each LRA be reasonable or even reliable. AReM has no information on the standards set by non-CPUC LRAs (and requests such information below). If, however, some of the LRAs set unreasonably low standards and the CAISO is required to procure capacity under the RCST as a result, then *all* LSEs pay for those costs. This outcome is unfair and discriminatory. The CAISO was the primary driver in the ultimate RA requirements adopted by the CPUC and it should be similarly engaged in ensuring comparable rules are adopted by other LRAs. AReM proposes the following two alternatives to remedy this problem:

- **Minimum RA Standards** – The CAISO’s tariff includes minimum standards for LSEs, but *only* if the LRAs have not adopted their own. The CAISO’s tariff should establish minimum reliability standards that all LSEs must meet or exceed. Then, the potential for subsidies is eliminated.
- **Changes to Cost Allocation** – Alternatively, the CAISO could designate the LSEs responsible for the capacity procurement. Clearly, any LSE that did not meet its LRA’s RAR can be tagged for the procurement costs. We expect this situation to occur rarely, particularly for CPUC-jurisdictional LSEs who pay a hefty penalty for failure to comply. So, the CAISO would be obligated to identify which LRA’s standards were creating the need for the capacity procurement and charge that LRA’s LSEs for the costs. The CAISO must decide the extent to which it will be able to make this determination. If not possible, then the only workable alternative is setting minimum RA standards that are codified in the tariff.

Cost Allocation for Zonal Needs – The CAISO has agreed not to pursue specific LSE zonal requirements for CPUC-jurisdictional LSEs and has, instead, proposed zonal import allocations (which have now been proposed for approval in the Phase 2, Track 1 RA Proposed Decision issued May 22nd). The CAISO must, therefore, ensure that it *does not* procure any zonal capacity under its capacity procurement mechanism that is attributable to CPUC-jurisdictional LSEs or allocate them any zonal costs. The CAISO has affirmed in its filings at the CPUC that, with the import allocations, all zonal needs are met. If any non-CPUC LRAs fail to abide by the zonal import allocation requirements, then resulting CAISO procurement must be allocated to those LSEs.

Significant Events – All parties need to understand when the CAISO will use the capacity procurement mechanism and particularly when a “Significant Event” will trigger such procurement.

Definition -- Significant Events should be clearly and precisely defined. AReM’s major concern is that the current definition allows fairly open-ended procurement options by the CAISO and socialization of the costs to all LSEs. AReM would like the CAISO to attempt to define the possible universe of events that might qualify as “significant.” For example, the CAISO should include a forced outage of the Intertie or a 1,000 MW power plant as types of Significant Events. AReM does not agree that “formal” changes to a CEC

load forecast are grounds for designating a Significant Event. As mentioned at the May 18th meeting, the CPUC-jurisdictional LSEs meet a Planning Reserve Margin (PRM) of at least 115%, which already compensates for load forecast error.

Time Limit for Designation -- A "Significant Event" should be an identifiable occurrence that requires *immediate* action. Consequently, the successor arrangement should require the CAISO to make the capacity designation to meet the reliability needs associated with a Significant Event within 30 days of the event's first occurrence. The CAISO should be prohibited from going back month's after-the-fact, designating a "Significant Event," and procuring capacity retroactively.

Compensation – The price of the capacity procurement mechanism will unavoidably drive the LSEs' RA price. Consequently, AReM is extremely concerned about setting a reasonable price for this RA backstop mechanism. AReM does not agree that the RCST should be sending a price signal based on the cost of new capacity. Such a price signal would instead be sent by a capacity market were one established. RCST is appropriately for backstop RA procurement and the relevant "price signal" is for RA capacity in the very near term.

AReM proposes the following changes to the current structure to send clear and reasonable price signals for setting the price based on pure capacity. Further, the capacity price should not represent the highest possible price on the system, which is simply another form of penalty. The CPUC-jurisdictional LSEs are already subject to penalties if they fail to meet their RA requirements. The capacity price for this backstop service should be a reasonable estimate of the actual price paid for this service in the market. This approach would simplify the pricing structure and send a clear capacity price signal for RA. AReM proposes as follows:

1. The price paid to the designated resource should be for pure capacity.
2. The CAISO could set one capacity price for the CAISO grid or could set two prices -- a System and Local capacity price.
3. The capacity price should be calculated based on the capacity that can qualify for designation. This calculation would be based on a reasonable estimate of prices for existing generation and any proxy for new generation that could be built and on-line within 6 months.
4. When a designated capacity resource is called on by the CAISO to provide capacity, the resource should be subjected to the same requirement as a resource under RA (i.e., bid into the DAM and RUC) and is paid the current market price

Minimum Term of Payment When Designated – Payments must align with RA compliance. When designated by the CAISO, the capacity resource will receive capacity payments under the tariff for the remainder of the year. So, a resource designated in July would receive payment from July through December. If the CAISO designates the resource in November or December for the following RA compliance year, the resource would receive capacity payments for the 12 months of that RA compliance year. AReM disagrees with IEP's position that designated resources are entitled to receive 12 months of compensation once designated, whenever that might occur.

RA Credit – The current and proposed procurement schedule *does not* work well with RA compliance, particularly if Local RA capacity is procured. Designation of resources for capacity procurement would occur in November or December, *after* the CPUC-jurisdictional LSEs make their annual RA compliance filings. Although the only remedy appears to be

monthly true-ups for the Local RAR, this has not been approved by the CPUC (and is not approved in the Track 1 Proposed Decision). Therefore, RA credits from this capacity procurement mechanism could only be used by LSEs in their monthly System RAR filings. If the CAISO procures above and beyond for reasons other than deficiency by an LSE and the credit is allocated, it is still unclear as to who exactly has the ability to use the RA credit in compliance demonstration for their local/system RA. Further, AReM urges the CAISO *not* to fix the timing of annual RCST procurement in its tariff. More flexibility is needed to make the RMR/RCST/RA procurement processes mesh better and in the event that RA compliance dates change.

C. Request for Additional Information

To avoid discriminatory practices, the CAISO must treat publicly-owned utilities (POUs) comparably to the LSEs complying with the CPUC's RA requirements. To ensure that the CAISO has encouraged the adoption of fair and reasonable standards for both the CPUC and non-CPUC jurisdictional LSEs, AReM requests that the CAISO provide information about the standards met by LSEs under each jurisdiction and how the Local Capacity Requirements are assigned to each jurisdiction.

D. Request to Modify Statements in the Issues Paper

AReM must respond to the discussion that appears on p. 4 of the CAISO's paper under the heading, "Functions of the Backstop Capacity Mechanism." AReM objects to the statement that LSEs have an incentive to "under-procure" in their RA showings and to allow the CAISO to procure RMR instead, thereby having the costs allocated to all LSEs. This is not true for the CPUC-jurisdictional LSEs who must pay significant penalties if they fail to comply. The CAISO must correct its paper to reflect these facts. This paragraph goes on to state that the RCST approach is preferred because the backstop costs can be targeted to LSEs that have a deficiency. However, as described above, the current RCST arrangement does not include a reasonable way to measure when some LSE are deficient, which *can* lead to subsidies.

Comments of Dynegy Power Marketing, Inc.
May 29, 2007

Following the May 18 stakeholder meeting backstop procurement, Dynegy is forwarding its comments on the development of a new CAISO backstop mechanism.

At the outset, Dynegy is opposed to extending RCST. RCST was a negotiated settlement with several provisions that were objectionable to several participants. Since, it was anticipated that RCST would be terminated on December 31, 2007, Dynegy and other agreed to accede to RCST as a temporary fix. Extending the tariff would disregard the spirit of settlement agreement.

Second, with the CPUC Resource Adequacy (RA) Local Capacity Requirement (LCR) programs in effect, LSE's have a requirements to procure through bi-lateral contracts, all required local and system capacity and an appropriate quantity of planning reserves. Thus, CAISO backstop procurement will only be required in rare instances where LSEs have failed to meet their obligations or that CAISO local and or system needs exceed the amount procured by the LSEs.

Accordingly, the following recommendations are proposed;

- The price of the backstop product in a local area should be based on the rational cost of new capacity in California that is capable of providing capacity and non-spin. Today the cost of new construction in California (especially in load pockets) is well in excess of the \$73/kW-year RCST compromise number.
- Capacity should be stated as an annual quantity (as it has been established by CPUC RA process and as it was accepted by FERC in RMR negotiations) and any backstop capacity should be procured on an annual basis. The CAISO requirement for these services should be based on its local/system/zonal operating criteria and its load forecast.
- Deviation from the 12 month capacity rule stated above should occur only under extremely rare occasions (for example, unforeseeable multiple transmission or generation outage conditions), where CAISO should be able to acquire capacity service on a short term basis. It should be noted that under- LSE RA and LCR procurement for any reason (including erroneous load forecast, over-reliance on renewable resource capacity, over-estimation of demand side efforts, etc.) should not be considered as the basis for the CAISO to procure daily capacity.
- FERC has instructed CAISO to develop a market for services such as black start and voltage support instead of using RMR contracts to secure these services. The CAISO should not use the backstop procurement process to secure these services. We understand, however, that it will take CAISO some time to develop and implement tariff and compensation provisions for voltage support and black start and as such, Dynegy is open to a short transition period for CAISO to use backstop procurement to secure these services.

- As most local and system capacity is required to be procured under the CPUC's RA mechanism, the CAISO should only require one "safety net" mechanism to procure capacity to maintain reliability. The proposed backstop mechanism eliminates the existing Reliability Must Run agreement.

The CAISO has indicated that they would retain the RMR contract to procure voltage support and black start. Dynegy does not support this position for the following reasons;

First, the CAISO LCR analysis already accounts for local area voltage support criteria.

Second, CAISO has never procured black start service under Dynegy's existing RMR contracts.

Thus, since it is highly unlikely that CAISO would utilize RMR resources for providing these services, it would not justify maintaining an RMR contract solely for these services.

- The performance requirement under the backstop procurement must be balanced and should not be unreasonably onerous. Dynegy recommends that CAISO review the existing RMR availability and non-availability penalty sections as a starting point to address both performance requirements and non-performance penalties.

We look forward to actively participating in the stakeholder process and working with the CAISO to develop an effective capacity backstop product.

Comments of Pacific Gas and Electric Company on CAISO Issue Paper on Interim Capacity Procurement Mechanism

Pacific Gas and Electric Company ("PG&E") is pleased to provide these comments are in response to the CAISO's request for input concerning the "Issues Paper: Tariff Filing for Interim Capacity Procurement Mechanism," dated May 9, 2007. PG&E appreciates this opportunity, and looks forward to participating in the efforts to address both interim and any long-term needs for a CAISO tariff-based capacity procurement mechanism.

Introduction

To the extent Resource Adequacy ("RA") resources are insufficient to satisfy system and other reliability needs, the CAISO may currently procure backstop capacity on a forward basis pursuant to the Reliability Capacity Services Tariff ("RCST"), which was established as a result of Federal Energy Regulatory Commission ("FERC") approval of an Offer of Settlement in *Independent Energy Producers Association v California Independent System Operator Corporation*, FERC Docket No. EL05-146. The RCST settlement also provides for increased compensation for daily commitment of resources through the FERC-ordered Must Offer Obligation ("MOO"). Given that RCST will expire on December 31, 2007, it is important and worthwhile investment for stakeholders to now address how the CAISO will commit backstop capacity after expiration of the existing RCST. The effort will help ensure that the CAISO, market participants and energy consumers receive maximum benefit from the interim backstop mechanism.

Scope and Applicability

The protracted negotiations to develop the existing RCST produced a carefully balanced and complex settlement. Any significant change to any element of the RCST settlement is certain to provoke controversy and extended discussion. Given the time remaining before the RCST expires, and before the Market Redesign and Technology Upgrade ("MRTU") is to begin, the existing RCST framework must be used to the maximum extent possible for two critical periods: (i) the period between the expiration of RCST and the start of MRTU, and (ii) the initial period of MRTU startup through the later of a reasonable time while MRTU is fully tested and determined to operate as expected, or until the potential revisions of the RA program under consideration at the California Public Utilities Commission is implemented. No change to the existing RCST mechanism should be necessary for the first period, and any revisions to the RCST mechanism for the second period should be limited to those essential to adapt the backstop procurement mechanism to the MRTU market structure.

The existing RA program is intended to provide the resources needed by the CAISO. It is PG&E's expectation that the need for any backstop commitment of resources under the interim mechanism would continue to be limited. The mechanism could be used when: (1) an LSE or LSEs fail to make an adequate RA showing and that inadequacy results in a failure to attain sufficient RA resources; (2) an additional need occurs because the effectiveness of specific resources procured under RA requirements is insufficient to meet all Applicable Reliability Criteria despite adequate procurement in aggregate; and (3) a Significant Event effecting the CAISO's operations necessitates the commitment of additional generating capacity. The interim capacity procurement mechanism should not, by design, replace Reliability Must-Run ("RMR") generation. The CAISO should not modify the RMR

process to establish a preference for either RMR or interim capacity procured under the interim capacity procurement mechanism.

Term of Interim Mechanism

The interim capacity backstop mechanism should address three periods. The initial period, as discussed above, would commence upon expiration of the existing RCST on December 31, 2007, and remain in place until MRTU start-up. The second period would commence at MRTU start-up, and continue through the later of the MRTU testing period or the full implementation of any major revisions of the California Public Utilities Commission (“CPUC”) RA program under consideration in Phase 2, Track 2 of the CPUC’s current proceeding, as well as any further, complementary development CAISO tariff changes that may be necessary for such implementation. The terms of the mechanism must fit carefully with those implemented for RA, and any substantial revision of any element of the current RCST mechanism should reflect, and support, any new RA structure that the CPUC may adopt.

Pricing

PG&E generally advocates continued application of the pricing provisions of the existing RCST mechanism. Under the RCST, compensation for generation capacity is based on a Reference Resource with a negotiated pricing structure (\$73/kW-yr). There appears to be little basis for revisiting this reference price which resulted from settlement discussions. Valid arguments in support of either a lower or a higher compensation rate could be made if this reference pricing mechanism is reconsidered, and opening discussion of this issue would undoubtedly lead to review of other elements of the balanced settlement as well.

Under MRTU, the CAISO must strike the correct balance between compensation under the Residual Unit Commitment (“RUC”) mechanism and the interim capacity procurement mechanism to ensure non-RA generators are not motivated to avoid RUC during conduct of the Integrated Forward Market mechanisms. Ideally, the CAISO should use RUC for very short-term needs and award RCST solely on a forward basis, with the only exception being for ongoing needs that spring from “Significant Events,” as currently defined. The designation of RCST resources could reflect preferences for non-RA resources previously committed through RUC.

Cost Allocation

The costs of backstop capacity procurement by the CAISO should continue to be allocated on cost-causation principles. The costs of backstop capacity procurement for LSEs that fail to make adequate RA showings should not be socialized, and should continue to be assessed directly to such LSEs, assuring proper incentives for LSEs to meet their own requirements and avoid need for CAISO procurement.

Conclusion

PG&E recommends that the CAISO build upon the existing RCST framework to the maximum extent possible in developing the interim capacity procurement mechanism. The interim capacity backstop mechanism should be effective upon expiration of the existing RCST on December 31, 2007, and, with minimal changes needed to reflect MRTU, continue until full development of California’s RA program. Further discussion of elements of the

mechanism, as needed to be consistent with future market design changes, should be coordinated with the development of those changes to ensure that the mechanism works properly, and is available when and to the extent needed.