Comments of Western Power Trading Forum

Regarding the California ISO DMM Exceptional Dispatch Mitigation Proposal[1]

April 4, 2008

I. BACKGROUND: On 3/28/2008, the California Independent System Operator ("CAISO") issued a revised proposal ***"Exceptional Dispatch: Options for Market Power Mitigation and Supplemental Pricing"*** ("ED Mitigation Proposal"). On 4/1/08, the CAISO issued the ***"Supplement to Exceptional Dispatch White Paper"*** ("ED Supplement")***.*** The CAISO has asked for comments on both. In its ED Mitigation Proposal, the CAISO proposes to limit payments for a unit that is subject to Exceptional Dispatch ("ED") to the higher of the unit's default energy bid or the LMP, rather than paying the unit's bid price as set forth in the FERC-approved MRTU tariff. When the proposed ED mitigation is applied to units that are not obligated under Resource Adequacy ("RA"), Reliability Must Run ("RMR"), or Interim Procurement Capacity Mechanism ("ICPM") contracts,[2] the CAISO proposes to make an additional payment to those units. In the ED Supplement, the CAISO seeks input from stakeholders as to whether the ED mitigation should apply only to units that have RA, RMR, or ICPM contracts, thus eliminating the need for any additional payment to units that are subject to ED and do not have RA, RMR, or ICPM contracts.

II. WPTF OPPOSES THE CAISO PROPOSAL: WPTF continues to strongly oppose the CAISO's proposal to mitigate payments for ED. The proposed mitigation of payments for ED is an unwarranted intervention in the markets and represents an unwarranted form of price suppression. WPTF's opposition is based on the following arguments:

First, with respect to the need for mitigation, WPTF reiterates that, since the CAISO has repeatedly stated that ED will be a rare occurrence and invoked only in response to unanticipated situations, Scheduling Coordinators (SCs) have no practical way to anticipate when such calls will occur or how often they will occur. Since SCs will be unable to predict when they will be subject to ED, they will not be able to raise their offer prices in anticipation of ED without making themselves less competitive for other energy market opportunities that are more predictable and more certain. In short, SCs will be unable to realistically exercise market power on the initial ED call, a fact that the CAISO has already recognized. Moreover, even if an SC had the perfect foresight required to raise its offer price in anticipation of an initial ED event, the impact of its actions on market prices would already be mitigated because the FERC has already ruled that offers from units subject to ED cannot set the market clearing

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[1] Exceptional Dispatch: Options for Market Power Mitigation and Supplemental Pricing, ("DMM Revised Proposal"), issued by the CAISO on 3/28/08 and Supplement to Exceptional Dispatch White paper, dated 4/1/08.

[2] WPTF notes that neither TCPM nor ICPM have yet been approved by FERC. WPTF and/or its members have submitted or may submit comments and/or protests to those mechanisms in the appropriate proceedings.

price. The CAISO's concern that market power could be exercised for hours subsequent to the first hour of an ED call can, and should, be addressed by market monitoring, rather than by simply refusing to pay a unit's bid price. Price suppression is not a reasonable substitute for actively monitoring market behavior and taking appropriate action if and when abuses are detected. Rather than preemptively limiting payments for ED, WPTF suggests the CAISO's proposal should instead describe how it will detect abuses and how it will address them.

Second, it is wholly inappropriate to suggest that any unit that is receiving a capacity payment should have its Exceptional Dispatch payments limited so as to prevent over recovery of fixed costs. While both capacity and Exceptional Dispatch are, without a doubt, forms of insurance, they provide the CAISO with very different forms of protection. The capacity provided under RA, RMR, or ICPM ensures the CAISO has enough resources to meet its reliability needs, while ED provides the CAISO with real time operating insurance in the form of energy. To suggest that a unit that is subject to ED must be paid less because it is receiving a capacity payment implies that the same analogy will or should be applied to other market revenues, including ancillary services revenues and, ultimately, energy revenues. Furthermore, suggesting that energy payments need to be further mitigated because a generator is receiving capacity payments is an untenable circular argument, since it is generally agreed that capacity payments are needed because energy payments are capped and spot market revenues fall short of covering annual fixed costs.[3] Proposals to mitigate or limit payments in one CAISO market because revenues are available in another CAISO market lead down a slippery slope that ends in regulated, cost-of-service pricing for wholesale power. As such, these proposals, if adopted, will undermine the foundation upon which competitive markets are built and the basic premise of the CAISO LMP market. WPTF acknowledges that ED has already been approved under MRTU as an out-of-market tool, and that the FERC-approved MRTU rules inherently exert an undesirable influence on market prices because they prohibit units called under ED from setting the LMP. In other words, the ED mechanism as currently approved for MRTU already has an adverse impact on the integrity of market prices. However, the CAISO's mitigation proposal would be even more damaging to market signals because it introduces confusion about the products being procured in the market and extends the adverse pricing impacts of ED beyond the energy market into the capacity and ancillary services markets.

Third, the CAISO has suggested that another potential reason for its ED mitigation proposal is to ensure that generating units for which the CAISO may eventually seek an ICPM designation are not incentivized to reject that designation in favor of securing ED revenues. Putting aside for the moment the point made above that ED is largely an unpredictable event and therefore not amenable to the sort of arbitrage that the CAISO seems to think may occur, the fundamental fact is that the CAISO's adaptation of ICPM creates a structure where there are two different "insurance" products, and arbitraging between those two products is a normal market-based activity. Even so, a generator is unlikely to pass

[3] 2007 CAISO DMM Annual Report on Market Issues and Performance, Figures E.8 and E.9

up the revenue certainty of an ICPM designation, if offered, for the unpredictable and highly uncertain revenues from ED, but the risk that a generator may do so exists primarily because it has two separate CAISO backstop products – ED and ICPM – from which to choose.

Fourth, the CAISO has muddied the waters so to speak by suggesting that ED calls should receive capacity payments. Exceptional dispatches are energy responses to an emergency condition. Nevertheless, the CAISO's ED Mitigation Proposal would mitigate all ED calls other than those needed for system-wide balancing. Should the mitigation affect a unit that is not receiving some form of capacity payment through RA, RMR, or ICPM, the CAISO proposes to "remedy" the mitigation in part by offering side payments, which the CAISO characterized at one point as a daily capacity payment. In effect, this feature of the proposal transforms Exceptional Dispatch from emergency energy to emergency capacity. Offering side capacity payments to compensate for an unwillingness to pay an energy bid price further reduces the transparency of the dispatch, a dispatch that should have been reflected in the IFM. Additionally, the CAISO's suggestion that ED calls may be used to compensate for poorly defined ancillary services needs (e.g., dispatchable reserves in SP26) indicates that CAISO plans to use an out-of-market mechanism to purchase what should be procured through market-based services. This is unacceptable; CAISO should clearly identify, define and implement the ancillary service products it really needs or it should be willing to pay the price of higher quality ancillary service products that merit higher prices. The CAISO should not rely on out-of-market ED to procure these market-based services, and it should not attempt to acquire these services at a discount by improperly mitigating bid prices.

III. REQUIRED MODIFICATIONS TO THE PROPOSAL: If, in spite of WPTF's opposition, the CAISO continues to seek approval of this proposal, WPTF urges the CAISO to provide time for further vetting this proposal and incorporating the following features:

1. A generating unit that is subject to ED and ED mitigation pursuant to this proposal must have the opportunity to receive an additional payment to compensate for the extra costs incurred above the ED-mitigated level to supply Exceptional Dispatch service, such as intra-day gas costs, local distribution company ("LDC") and pipeline gas imbalance charges, any gas scheduling penalties and any charges for LDC firm access rights WPTF notes that this should not present any significant implementation issues for the CAISO since the entire ED proposal impacts settlements only. The process by which a generator seeks this additional payment should be clearly stated, and all such requests for additional compensation should be resolved within two weeks of the time they are received.

2. How the CAISO's use of Exceptional Dispatch should trigger an ICPM designation must be further discussed in order to ascertain the level of any incremental ED payment. Since the start date for MRTU has been delayed, taking the time required to develop a reasonable proposal that incorporates such modifications should not be problematic for the CAISO.

IV. Conclusion: The CAISO should carefully consider what it hopes to accomplish with this proposal. Exceptional dispatches are already mitigated. The CAISO acknowledges that by its very nature, ED will be the "exception". In addition to the significant market distortions that the CAISO's proposal introduces, the notion of providing side payment to mitigated units calls into question why moving revenues from energy payments to capacity payments benefits anyone in the market. At a fundamental level, the CAISO has created so many out-of-market mechanisms that they are beginning to get in each other's way. The CAISO should carefully consider whether consumers and market participants would be better off it the CAISO simply procured the products in the market that it requires to meet its reliability needs rather than relying on out-of-market mechanisms.

There is real work to do to improve the CAISO markets and implement robust LMP and capacity markets in CAISO, and we encourage the CAISO to carefully consider whether the level of the expected risk, the adverse consequences of the mitigation and the other important issues to which the CAISO and stakeholders could instead be devoting the efforts.