



January 23, 2008

Mason Willrich, Chair
California ISO Board of Governors
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VIA EMAIL

The Western Power Trading Forum (WPTF) is concerned about the CAISO's change to its market design absent any meaningful stakeholder processes. Of particular concern are the proposed payments for "backstop" capacity, and the proposal to eliminate payments of bid amounts for Exceptional Dispatch. Both are detrimental to competitive markets. WPTF respectfully requests that the Board take notice of the items herein, and reject outright the CAISO's Exceptional Dispatch proposal. Without such action by the Board, a generating-asset owner in the CAISO grid possessing a unit without a Resource Adequacy (RA) or Reliability Must Run (RMR) contract will have to choose between exiting the market via closure, or accepting backstop-capacity prices that are clearly non-compensatory.

WPTF is a strong supporter of competitive wholesale markets and supports the major components of CAISO's Market Redesign and Technology Update (MRTU). WPTF has been a constructive participant in CAISO's MRTU design process, both at stakeholder meetings and before the California Public Utilities Commission ("CPUC") and the Federal Energy Regulatory Commission ("FERC"). The particular topics highlighted below describe our concerns.

Procurement of backstop capacity resources: Backstop capacity compensation during 2006 and 2007 was governed by a Reliability Capacity Services Tariff ("RCST") settlement, which was, in turn, the result of a negotiated settlement process that began in the summer of 2005. While the CAISO became aware in December 2006 that it would not implement MRTU prior to the expiration of RCST, the CAISO did not begin a stakeholder processes to replace RCST until April 2007 with an intention of making a FERC filing in September 2007. The CAISO's stakeholder process to develop a

replacement backstop procurement mechanism has not been concluded. On September 19, CAISO filed a motion that essentially stated it would not file a backstop capacity pricing mechanism until early 2008 and that its proposal, known as Interim Capacity Backstop Pricing (ICPM) mechanism, would be implemented concurrently with the start of MRTU, scheduled to begin on April 1 2008. For the period between the expiration of RCST and MRTU deployments, the CAISO initially proposed that compensation to generators would revert to the old must offer compensation, which FERC had already ruled to be unjust and unreasonable. CAISO's proposal created a serious gap—one that may last for most of 2008 if MRTU is delayed --in compensation for generators needed for reliability but without a RA or RMR contract.

In terms of CAISO's actual proposal for backstop capacity payment, known as ICPM, CAISO has adamantly opposed compensation based on replacement cost and has instead focused on compensation tied to going forward costs. Given that over 5,000 MW of new capacity has been built in the last 4 years, this creates the very real possibility of discrimination between new and existing generators providing the same reliability service and creates incentives for load serving entities to under-procure resource adequacy capacity. Generators that elect to remain available in the absence of RA or RMR contracts will still have to rely heavily on compensation from MRTU's spot energy markets and the CAISO's Residual Unit Commitment availability payment to cover costs of operations or may have to face harder decisions such as early retirement or mothballing of units.

Exceptional Dispatch: Exceptional dispatch is a tool available to CAISO operators that allows dispatch of resources not otherwise dispatched in accordance with the CAISO's real-time market model. Exceptional dispatch can occur both day-ahead and in real-time. Such dispatches under the currently approved market design would receive the highest of its bid price, its default energy bid price, or the LMP at the unit's location. To the extent the bid or the default energy bid was higher than the LMP, such dispatches would not set LMP. In short, absent a resource being made available to the CAISO pursuant to an RA or RMR contract, and in the absence of a replacement for the expired RCST authority, Exceptional Dispatch would be the remaining tool available to the CAISO for managing reliable operations. On November 30, 2007 the CAISO proposed a significant change to its rules for settlement of units subject to Exceptional Dispatch. The CAISO proposed that a unit called pursuant to Exceptional Dispatch for any reason except to provide general system energy would not be eligible to receive payment equivalent to its bid price. Instead, a generator subject to the payment would receive only the higher of LMP or the Default Energy Bid (DEB). DEBs expressly do not include any recovery of fixed costs, which is a normal return in a functioning competitive market.

The Link Between ICPM and Exceptional Dispatch: CAISO indicates that its proposal to allow units to decline an ICPM designation is one motivation for changing the proposal. Per its October 2007 discussion paper on ICPM and Exceptional Dispatch, "Stakeholders have raised the concern of whether a resource would reject an ICPM designation in favor of collecting revenues under Exceptional Dispatch."

The level of "mitigation" CAISO is proposing is unacceptable--we do not see the same level of market mitigation in any other LMP market. The CAISO has abandoned its approved MRTU market design without sufficient time for a meaningful stakeholder process. WPTF is concerned that the fragmented changes of both (1) non-compensatory backstop capacity pricing, and (2) the mitigation of exceptional dispatch will create unjust and unreasonable compensation for suppliers.

Sincerely,

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