

**The CPUC's comments on future CAISO backstop procurement methods
May 31st, 2007**

The CPUC appreciates the opportunity to comment on the CAISO's initial discussion of the need for backstop procurement mechanisms during three distinguishable periods in the near to far future:

1. Pursuant to the agreement between the settling parties, the current RCST expires on **12/31/07. From this point until the start of MRTU**, the CAISO will have continuing ability to use the FERC Must Offer Obligation ("FERC MOO"). The CPUC supports the CAISO's proposal that California should pursue implementation of a product that is as close to the current RCST program as possible. The submission of a nearly identical product for FERC approval is likely to result in a quick and uncomplicated approval process, as FERC already approved the current product and stakeholders have expressed little immediate concern with this methodology.
2. **Upon startup of MRTU**, the FERC MOO goes away, the absence of which will call for alterations of the current RCST methodology.
3. **After the publication of a CPUC Decision in Resource Adequacy's ("RA") Track 2**, which is considering the appropriate structure for trading capacity. The resulting market structure may replace some or all of the CAISO's backstop capacity procurement activities.

The proposed decision in the CPUC's RA Track 1 proceeding envisions the ISO RMR-ing for 2008 any units RMR-ed for 2007 that are not bought for RA or replaced by RA resources with similar effectiveness factors. Similar to 2007, in September LSEs will submit preliminary RA compliance filings identifying local resources receiving RA contracts. This filing will inform the CAISO in renewing RMR contracts for 2008. For example, the CPUC understands that SDG&E signed RA contracts with some RMR units for 2008, so their RMR procurement needs should be reduced in 2008.

Backstop may be needed to account for LSEs' collective failure to procure system and local capacity (i.e., one or more LSEs are short in RA procurement, and the procurement of long LSEs does not cover the gaps left by short LSEs), and to address collective error (e.g., all LSEs meet their system and local RA requirements, but needs are not met due to deliverability issues with the portfolio of resources actually procured). The CPUC does not believe that the CAISO should procure to meet individual LSE deficiencies where other LSEs' procurement fulfills the deficiency. Another key principle is that the CAISO should not use its backstop authority to call a non-RA resource before an effective RA resource .

CPUC staff believes that procurement for the above named deficiencies should be limited to the same period as the RA obligation. Local RA deficiencies should be

procured for the whole year, monthly system deficiencies for the relevant compliance month, and year-ahead system deficiencies procured up to 90 percent of the RA requirement, but only for the deficient summer months. The capacity backstop product should have the same obligations and MRTU bidding requirements as an RA contract (e.g. the unit must bid in the day-ahead market, and bid \$0 for availability in RUC). Backstop for shorter periods of time should only occur because of “significant events.”

The 2008 RA year will include the period before MRTU goes into effect and the start-up of MRTU. CPUC staff recommends the backstop process should be the same for calendar year 2008. CAISO should not be precluded from performing appropriate backstop of a local RA deficiency in fall 2007, after the LSE local filings, because part of the backstop period is pre-MRTU and part is after MRTU start-up.

Significant Event

CPUC staff recommends that examples of what is and is not included in the definition of “significant events” should be identified within the tariff. Examples include line/transformer failures and RA generator long-term outages that significantly impede the CAISO’s ability to meet forecast load plus operating reserves on a sustained basis. RA procurement obligations include reserves to address contingencies. If a contingency occurs, it should not be assumed to be a significant event. Generator and transmission line failures are built into the system, so a significant event should be limited to events or multiple events that threaten operating reserves. For example, for 2007 the CPUC adopted the CAISO recommended N-1-1 on a year ahead basis. If a contingency occurred during the year, reserves of at least N-1 would be available and so no backstop should be required. A second event could be considered a significant event if it caused reserves to fall below N-1. Similarly, the adopted system planning reserve margin includes consideration of forced outages. A significant event would occur if forced outages exceed levels included in the planning reserve margin. RCST designations should be narrowly tailored in duration to meet the identified deficiencies.

The CPUC expects that the CAISO’s report on RCST use during the summer of 2006 may inform this process. The CPUC has not, however, had the opportunity to thoroughly digest this material, and may provide supplemental comment on this subject later in the discussion of a RCST replacement mechanism.

At the CAISO’s stakeholder meeting on May 18, 2007 there was the suggestion that the backstop capacity product stakeholder process should sunset after a specified time. One suggestion was for a three year sunset. CPUC staff agrees any backstop process should be subject to periodic review although an automatic sunset may be administratively burdensome if a review reveals the process is functioning appropriately.

Identified Services

It is critical that the CAISO provide enough definition of reliability needs so that LSEs can procure to meet system and local RA requirements. The CPUC would like the backstop product to identify the proper method of supplying all reliability services the CAISO requires, but which are not currently procured in RA. Alternatively, the CPUC could create an RA requirement for non-energy/non-capacity services. Such services include blackstart, dual-fuel, voltage support, automatic generation control, and any other reason the CAISO thinks it needs to RMR or MOO a unit. Any solution to this issue should take note of the joint product quality of many of these services.

The CAISO indicated that it is going to wait until after it has a chance to develop a backstop proposal to competitively procure blackstart, dual fuel and additional voltage services to define requirements for these services. The CPUC urges the CAISO to define these products now so that LSEs can procure to meet these needs. Such definition would provide market transparency and potentially reduce RMR contracting in 2008. The CPUC recognizes that the CAISO will also need to determine how to competitively procure these services as a separate effort from defining them.

Generator Compensation

The CPUC appreciates input regarding generator compensation issues. There was suggestion at the CAISO's stakeholder meeting on May 18, 2007 that compensation should be linked to the cost of new peaking units. The CPUC is concerned that opening the issues of compensation for calendar year 2008 could delay adoption of a backstop process for 2008 and therefore, opposes this proposal at least for the period prior to MRTU startup. For the period after MRTU startup, the CPUC fundamentally opposes any compensation rate that may incent generators to refrain from RA contracting, but is otherwise open to reasonable options.

At the CAISO's stakeholder meeting it was also proposed that the backstop capacity product should sunset at a specified time. One suggestion was for a three year sunset. CPUC staff agrees any backstop process should be subject to periodic review, although an automatic sunset may be administratively burdensome if a review reveals the process is functioning appropriately.

Cost Allocation Issues

SCE has commented that it is unfair to consumers for the CAISO to continue to use the same level of RMR at while the CPUC has a LSE-based RA requirement. A key concern is that it is unfair to LSEs that procure their RA requirements to also have to pay for RMR costs because of the deficiency of other LSEs, whether within or outside of CPUC jurisdiction. The CPUC staff is similarly concerned that RMR use be limited. The costs of reliability services should be allocated on a cost causation basis and no LSE or LRA should be able to shift costs to other entities.