J.P. Morgan Comments on CAISO Draft Final Proposal "Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch"

Submitted By	Company	Date Submitted
Steve Greenleaf *(916) 802-5420*	*J.P. Morgan*	*September 3, 2010*

J.P. Morgan Ventures Energy Corporation and BE CA, LLC (collectively, "J.P. Morgan") appreciates this opportunity to provide comments on the California ISO's (CAISO's) August 16, 2010, Draft Final Proposal entitled "Capacity Procurement Mechanism, and Compensation and Bid Mitigation for Exceptional Dispatch" ("Draft Final Proposal").

Overall Proposal

1. Whether you support the overall proposal.

No. J.P. Morgan supports CAISO authority to procure backstop capacity in order to address Resource Adequacy ("RA") procurement deficiencies, maintain the availability of resources needed for reliability, and to address various short-term operational needs. However, J.P. Morgan disagrees with the CAISO's proposal to pay resources needed to provide such capacity based on going-forward fixed costs. Consistent with its earlier comments, J.P. Morgan recommends that such capacity be priced based on the Cost of New Entry ("CONE") and therefore supports the CAISO's previously articulated "Option A" pricing proposal that uses a CONE-based administrative demand curve. J.P. Morgan supports a CONE-based pricing methodology because it creates appropriate incentives for the development and deployment of the capacity resources (be they generation or demand based) necessary to ensure both the short and long-term reliability of the system.

As acknowledged by the CAISO, compensation for "capacity" will take on expanded and ever-important role as more and more renewable resources are integrated on to the power system. Energy and ancillary service market revenues are likely to remain low, if not further decrease with the introduction of more renewable resources on to the system. (See, for example, Tables 5.4-5.6, in the CAISO's August 31, 2010 paper, "Integration of Renewable Resources Study Operational Requirements and Generation Fleet Capability at 20% RPS") Therefore, it will be even more important to establish transparent and meaningful prices for capacity; prices that will ensure that existing resources make themselves available to the CAISO and that both existing and new

resources make the investments necessary to support the short and long-term operating and reliability requirements of the system.

While JP Morgan recognizes that the CAISO's proposed Capacity Procurement Mechanism is not, by itself, a sufficient vehicle for investment, the CPM can and should inform and influence forward contracting decisions through which necessary investments are made. Similar to the inherent price signals supposed to be produced from the CAISO's new market – price signals that, as frequently stated by the CAISO, are intended to inform both short-term resource operating decisions and longer-term investment decisions – the price of capacity services secured via the CPM will likewise inform resource operating (availability) and investment decisions. The CAISO cannot ignore its role in ensuring adequate and appropriate compensation for resources necessary to ensure both the short-term and long-term reliability of the system. As stated above, J.P. Morgan therefore supports a CONE-based CPM pricing methodology similar to that outlined and considered by the CAISO earlier in this process.

2. Whether the proposal strikes the appropriate balance among difficult issues.

No. See answer to (1) above.

Capacity Procurement Mechanism ("CPM")

3. Whether the tariff provisions should have a specific sunset date or be open-ended.

See previous comments. The CAISO should establish a permanent backstop capacity mechanism. However, to the extent that the CAISO proceeds to adopt and file at FERC the proposed CPM, any tariff provisions supporting such a proposal will need to be replaced once a more complete market design is established.

4. The ability to procure capacity for planned transmission and generator outages or sustained, significant less-than-planned-output of intermittent resources.

See previous comments. J.P. Morgan supports CAISO authority to procure backstop capacity for a variety of reasons. Ideally, such capacity should be priced through the market, be it through a forward market for such capacity or through appropriately developed market products and/or services facilitated through the CAISO's day-ahead or real-time markets.

5. The proposed treatment of procured capacity that subsequently goes out on planned outage during the period for which the capacity has been procured.

See J.P. Morgan's previous comments on this issue.

6. Modification of the criteria under section 43.3 of the ISO tariff for selecting capacity from among eligible capacity.

See J.P. Morgan's previous comments on this issue.

7. Procurement of capacity that is needed for reliability and is at risk of retirement.

See J.P. Morgan's previous comments on this issue and the response to item (1) above.

8. The compensation methodology for resources procured under CPM and Exceptional Dispatch.

See J.P. Morgan's previous comments on this issue. Resources exceptionally dispatched/committed by the CAISO should be compensated on a basis comparable to other capacity resources. Also, the CAISO should reevaluate and redesign its Competitive Path Assessment methodology so that it does not arbitrarily and unnecessarily mitigate resources necessary to manage congestion on the CAISO grid.

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Exceptional Dispatch

1. Linking compensation for Exceptional Dispatch to the CPM Payment.

See answer to item (8) above.

2. Extending the existing bid mitigation.

See answer to item (8) above.

Other

1. Additional comments.

In light of the market design/resource compensation issues at issue in this effort, J.P. Morgan recommends that the CAISO solicit the opinion of the Market Surveillance Committee regarding the appropriate compensation for capacity resources and the role of the CAISO markets in establishing and maintaining an appropriate resource compensation framework that supports the short-term and long-term reliability of the system.