

COMMENTS OF STRATEGIC ENERGY ON THE CAISO'S LOCAL RELIABILITY AREA STUDY PRESENTED JUNE 29, 2005

Strategic Energy appreciates this opportunity to provide comments on the CAISO's results of the local reliability area (LRA) study presented on June 29, 2005. Strategic greatly appreciates the effort of the CAISO's staff to analyze the LRAs and calculate the local resource adequacy requirements (RAR). This was truly a considerable challenge given the short time available. Strategic notes that there are many complex policy issues to be resolved for the local RAR and offers the following comments.

CAISO's Criteria for Determining the Local RAR Are Too Stringent

Strategic is concerned that the CAISO's criteria for determining the local RAR may be too stringent, thereby leading to local RARs that may be much larger than necessary. At the June 29th meeting, the CAISO admitted that several of the criteria it used to calculate the local RAR went "beyond" the NERC and WECC requirements. Strategic agrees that the CAISO may need to analyze the system based on such stringent criteria for operational purposes. However, the local RAR was intended to be a *planning* requirement for LSEs. Strategic is concerned that the local RAR now looks much more like an *operational* requirement intended to meet even low probability scenarios. Strategic urges the CAISO to re-examine its criteria consistent with NERC and WECC guidelines.

Local RAR Must Pass a Cost-Effectiveness Test

A critical element of the local RAR evaluation seems to be missing – an assessment of the cost the local RAR will impose on LSEs and a determination of whether that cost is just and reasonable. Transmission planners evaluate both risk and costs. For example, if the risk of a particular scenario is low (such as the loss of two generating units combined with the loss of a transmission line), transmission owners are unlikely to build costly upgrades. On the other hand, the transmission owners would be willing to consider operational solutions or involuntary load shedding (if acceptable under the criteria). Also, Strategic understands that transmission owners frequently ignore low probability "problems" because the cost to solve the problem is prohibitive. Strategic recommends that the CAISO factor cost into their determination of the local RAR. If the local RAR is based on a scenario that would not be relieved by the transmission owner, then it should not be a planning requirement for the LSE.

Market Power Remedies Essential

Strategic is aware that some parties have downplayed the need for the CAISO to provide the backstop role. Strategic disagrees and believes that the CAISO must provide the backstop for two reasons. First, the preliminary results indicate large local RARs relative to the available generation in the LRA. For example, in 10 of the 12 LRAs, more than 70% of the generation must be signed up by the LSEs (3 require more than 95% be signed up). This level of requirement creates market power where none would be there

otherwise. Second, several of the LRAs contain generation that is entirely owned by utilities and QFs. Strategic is concerned that it may be unable to achieve any local RAR in such areas. The CAISO is the logical counter to market power. Given the size and scope of the local RAR, Strategic expects the CAISO to be thrust into the backstop role often. Strategic supports the CAISO's proposal for Local Area Reliability Contracts (LARC) to ensure reliability until additional generation or transmission can be constructed. Strategic envisions that these LARCs could be signed for more than one-year terms to reflect the time required to get alternatives in place. In this event, the LARC would either supercede or reduce the local RAR for LSEs.

Demand Response Must be Allowed to Meet the Local RAR

As discussed at the June 29th meeting, the CAISO's current plan did not seem to include allowing demand response to meet the local RAR. Strategic urges the CAISO to reconsider. According to Strategic's understanding, certain NERC or WECC criteria allow the transmission owner to employ involuntary load shedding to meet the criteria. Logically, LSEs should have the same opportunity.

Local RAR Policy Must Provide Incentives to Relieve Constraints

Strategic is concerned about the apparent disconnect between transmission planning and the local RAR. Because the LRAs are created by transmission constraints, it is essential that the local RA policy provide an incentive to relieve the constraint, thereby relieving the LSEs of ever-growing burdens. Currently, the local RAR policy includes no such incentive. It is unclear, for example, that the requirement for LSEs to purchase capacity in a LRA will provide any incentive to build transmission upgrades. In fact, Strategic is concerned that the transmission owner could become complacent – it would have no need to relieve the constraint as long as the LSE had the burden to buy capacity and make it available to the CAISO 24/7. Rather, California needs another check to ensure cost-effective decision-making. Strategic suggests that the local RA policy include a trigger at which point upgrades are required, such as when the local RAR exceeds a specified percentage of total generation or peak load (e.g., 50%). At that point, the transmission constraint must be relieved and, until the constraint is relieved, the CAISO would be obligated to enter into LARCs in its backstop role.

Inability to Meet “Must Offer” for Local Reliability Resources Before MRTU

Strategic believes that no party has offered a concrete proposal describing how RA resources may be “offered” to the CAISO before MRTU is operational. Strategic is concerned, for example, that it will have no first-hand knowledge of a RA resource's operation. The CAISO does have this information, however. If the CPUC continues with its plan to require a local RAR by June 2006, the CAISO must work with stakeholders to develop a plan for how the “offer” could be made by the RA resource. The CAISO's plan should include reasonable compliance and enforcement rules that recognize the LSE's role and ability to control the RA resource.