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Montana Public Service Commission

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District 1

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To whom it may concern:

I want to thank the California ISO (CAISO) for its thoughtful "Proposed Principles for Governance of a Regional ISO," (Principles) which appears to borrow generously from thoughts that state regulators have offered in the course of the past months. This letter is not intended to be a comment on each and every part of that issuance, but only further to a handful of points I made at the California Energy Commission's (CEC's) June 20 workshop in Denver, on which I was asked to elaborate.

Before I offer that comment, however, let me say that as a Montana regulator, I am thankful that the CAISO, CEC, and others have been attentive not only to the parties within the footprint of the current CAISO's participating transmission owners (PTOs) and PacifiCorp, but of parties throughout the Western Interconnection. If done well, a Western ISO probably will appeal to states like Montana and possibly others like Nevada, Arizona, Colorado and New Mexico which are outside the footprint of the consideration presently on the table. Their views are important to hear also.

Capacity Market Language

The Principles would codify a prohibition on capacity markets in its promise of "a provision that prohibits the ISO from proposing or endorsing any centralized market for forward procurement of electric capacity products" (p. 2). This language is overly broad.

A market that requires load-serving entities (LSEs) to acquire all of the capacity necessary to meet a resource-adequacy obligation under an ISO tariff through a centralized capacity market is not reasonable for the purposes of a Western market, where most LSEs obtain capacity through long-term, bilateral or self-supply arrangements. I believe that protecting this long-standing model for electric generation in the West is what this prohibitive language has in mind.

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However, this language as written would apply to *any* forward procurement of electric capacity products. The Principles would thus prohibit even a *voluntary* centralized capacity market for *residual* capacity needs or surpluses.

I have personal experience with regulating a utility, Montana-Dakota Resources (MDU), a MISO member, which participates in purchasing or selling capacity into that ISO's voluntary capacity market. Like most other utilities in that market, MDU is largely vertically integrated, but is able to rely on the market for short-term forward capacity purchases instead of overbuilding generation to meet more distant future needs which may not materialize, or engage in a bilateral market which is less liquid and predictable. It is this flexibility which allows the MISO region as a whole to more effectively share generating resources, instead of merely limiting the function of a market to an optimized economic dispatch. If a central market in capacity products were prohibited outright, this inflexible aspect of market design would almost certainly prevent some of the forecast savings of a Western ISO.

It is important to note that even those most critical of the mandatory centralized capacity markets of the Eastern RTOs are nonetheless supportive of centralized markets for capacity products. As Jay Morrison, vice president of regulatory issues for the National Rural Electric Cooperative Association, has recently written:

> [T]here is nothing fundamentally wrong with the idea of centralized capacity constructs, so long as they operate neatly in conjunction with, and not in conflict with, bilateral markets and LSEs' self-build options. As with the voluntary centralized capacity market in MISO, they can be an efficient supplemental tool for enabling those who are long in capacity and those who are short to transact in the short term […]
>
> Centralized capacity constructs should be considered a supplement for, not a replacement or substitute for bilateral capacity markets and self-supply. Centralized capacity constructs should be 'residual to' bilateral markets and self-built resources, to provide an additional option to help LSEs manage their risks and portfolios.[1]

Bonneville Power Administration's representative at the June 20 CEC workshop echoed these concerns.

I believe it would be appropriate instead for the Principles to include language with respect to capacity markets like the following:

> Load-serving entities would be expected to make bilateral or self-supply arrangements for forward capacity products in order to meet the resource-adequacy requirements of the ISO. The ISO would be prohibited from proposing or endorsing a mandatory centralized capacity market through which all capacity products needed to clear in order to be counted for resource-adequacy purposes. Instead, the

[1] Jay Morrison, "Capacity Markets: A Path Back to Resource Adequacy," *Energy Law Journal* Vol. 37, No. 1 (2016), pp. 58-60.

ISO would be limited to proposing or endorsing a centralized capacity market which was residual and voluntary in nature, intended to allow LSEs to liquidate surpluses or make up for deficits in capacity products.

Transitional ISO Board

At the June 20 meeting, I discussed that the combination of a transitional board of directors (pp. 3-4) and a transitional committee of stakeholders (p. 3) seemed to be politically unpalatable because of the continued California majority of the former and also appeared to constitute a confused mandate as to which of those bodies would do which things.

I have no particularly detailed comment on this proposal, other than a belief that the transitional process should be more stream-lined and make a faster transition to a genuinely independent board with a regional perspective.

It has been my pleasure to provide comments to you on the Principles, and to participate in the broader process of creating a more efficient wholesale market in the Western Interconnection. Please do not hesitate to contact me should you have any questions.

Sincerely,

Travis Kavulla