

PUBLIC UTILITIES COMMISSION  
505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



October 26, 2009

To: CAISO  
Re: CAISO Final Draft Proposal for Reserve Scarcity Pricing Design  
From: Karl Meeusen, [kkm@cpuc.ca.gov](mailto:kkm@cpuc.ca.gov)  
Bishu Chatterjee, [bbc@cpuc.ca.gov](mailto:bbc@cpuc.ca.gov)  
Elizabeth Dorman, [edd@cpuc.ca.gov](mailto:edd@cpuc.ca.gov)

The CPUC staff generally supports the CAISO's Final Draft Proposal for the Reserve Scarcity Pricing Design. However, there are still outstanding issues that require additional consideration or modification. These issues include the interplay with demand response, the selection of the sub-regional triggers for Scarcity Pricing, and the discussion regarding capacity markets.

#### **Timing of Scarcity Pricing Implementation**

In previous comments, the CPUC staff urged that integration of Scarcity Pricing only after *effective* demand response resources are in place. In the presentation at the Market Surveillance Committee meeting on October 15<sup>th</sup>, 2009, the CAISO asserted that it "already has demand response tools at its disposal." The CDWR pump storage units were cited as the primary source of participating load, as well as progress being made through the CPUC authorized Participating Load Pilot (PLP) program. However, the presentation offers no evidence demonstrating the capacity, location, and availability of the pump storage units, and does not mention the PLPs are pilot programs in their infancy and only provide approximately 10 MW combined resources between all three Investor Owned Utilities (IOU).

Currently, the CAISO proposes to implement Scarcity Pricing and Proxy Demand Resource (PDR) simultaneously. However, there is still much work to be done on PDR. The CPUC has recently directed the IOUs to make modifications to at least one retail DR program (equivalent to 10% of the amount of enrolled megawatts in the budgets approved by the CPUC) to comply with the requirements of PDR. The IOUs are also directed to propose modifications to an existing program or create a new program that includes an ancillary services component which meets the requirements for PDR. These proposed modifications are due to the CPUC thirty days from the date that CAISO files its PDR tariff filing at FERC, which we understand to be no earlier than January 2010. Even if the proposed modifications are approved by the CPUC prior to April 1st, 2010, the amount of DR resources that can be reasonably expected to participate in PDR in 2010 will obviously be limited. In particular, a new program that includes an ancillary services feature will require additional time for marketing and enrollment of customers. Participation in such a program in summer 2010 is not expected to be significant. Additionally, the CPUC has not yet decided how retail customers will participate directly in products such as PDR, nor has it made determinations on how settlements between IOUs and load curtailment providers should be best structured. Given the various transitional factors at play, it is unlikely that IOU retail DR programs will be a significant PDR resource until the summer of 2011, at the earliest.

The CAISO also asserts that it will rely on Non-Participating Load (NPL) as a tool to mitigate Scarcity Pricing. If NPL frees additional capacity that is Ancillary Services (AS) certified, then it seems like a promising option for DR to mitigate Scarcity Pricing. However, there is nothing that necessitates that the capacity freed is AS certified. Additionally, many of the retail programs that participate as NPL can only be activated in the day-ahead time frame. This means that these programs will only be able to mitigate day-ahead scarcity prices and not real time scarcity prices. CPUC staff understands that reduced load schedules in the day-ahead market may reduce the likelihood of

shortages in the real time, but CPUC staff is concerned that these programs will have little impact if real time scarcity does occur.

Therefore, the CPUC staff seeks additional information regarding the demand response resources that the CAISO believes will be in place for the proposed start of Scarcity Pricing. Specifically, the CAISO should provide information regarding the size, location, and availability of Participating Load Resources. Such information should include whether the resources are located in sub-regions with minimum reserve requirements. Additionally, the CAISO should provide information regarding the likelihood that any capacity that is freed by NPL or other DR resources will be able to provide AS to mitigate Scarcity Pricing. If these resources are not sufficient to mitigate Scarcity Pricing and/or the probability of Scarcity Pricing, then the CPUC staff would like to reiterate the need to delay the start of Scarcity Pricing until April 1, 2011.

#### **Clarification Of Basis For Reserve Requirements**

In Section 2.2 on page 7 of the Final Draft proposal, the CAISO asserts,

“[T]he ISO has been procuring Regulation and Operating Reserves in the Expanded South of Path 26 Sub-Region of at least 35% of the minimum requirements for the reserves in the ISO Expanded Region. The ISO plans to use this minimum reserve procurement requirement for the Expanded South of Path 26 Sub-Region in the future until the need for a change is identified.”

The CPUC staff seeks clarification regarding the basis for this reserve requirement. Is this requirement part of the CAISO tariff, Business Practice Manuals, WECC or NERC requirements, or CAISO Operating Procedures? It is unclear what analytical steps were used to arrive at this requirement. CPUC staff believes that such a requirement should be subject to transparent discussion before it can be used as a trigger for sub-regional scarcity.

#### **Scarcity Pricing and Resource Adequacy Capacity Payments**

Section 3.3 of the Final Draft Proposal discusses the interplay of Scarcity Pricing and Resource Adequacy Capacity payments. The CPUC staff agrees with the proposal to the extent that it describes that SP is designed to address short-term reserve/reliability needs rather than long-term reliability (which is the CPUC’s jurisdiction), and as such, parties to RA contracts may allocate the cost/risk of scarcity pricing outside of the CAISO markets as they see fit. Additionally, on page 15, the proposal correctly notes that Resource Adequacy is currently handled through the CPUC bilateral capacity market. However, the final paragraph of section 3.3 should be clarified. This paragraph states,

“Therefore, the ISO proposes that the Scarcity Pricing design not disqualify bilateral RA resources from receiving scarcity prices, nor to adjust capacity payments to RA resources before the implementation of a centralized capacity market. *Capacity payment adjustment could be implemented with a centralized capacity market, as a part of capacity market design. The ISO will review the performance of the Scarcity Pricing mechanism after the capacity market is implemented.*” [Emphasis added.]

The CPUC is currently considering in a proceeding whether California should move towards development of a centralized capacity market (as opposed to the existing bilateral capacity market, which has been providing capacity to CAISO markets since 2006). Until such time as the CAISO and CPUC jointly embark on the development and implementation of a centralized capacity market, the word “after” in the final sentence above should be replaced with the phrase “if and when.” With that change, it will be clear that a decision to pursue a centralized capacity market has not yet been agreed upon.