

**BEFORE THE
PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Consider)	
Annual Revisions to Local Procurement)	R.08-01-025
Obligations and Refinements to the)	
Resource Adequacy Program)	
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**PHASE II PROPOSALS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to the Administrative Law Judge’s October 30, 2008 Ruling Adopting Dates Certain For, And Making Changes To the Phase 2 Schedule, the California Independent System Operator Corporation (“CAISO”) hereby submits the following proposals on the Phase II issues being addressed in the captioned proceeding. The CAISO appreciates the opportunity to address the issues set for consideration in the Resource Adequacy (“RA”) Phase II proceeding. Specifically, the CAISO provides below its proposals on the following issues:

- The Standard Capacity Product (“SCP”) proposal that the CAISO intends to file with the Federal Energy Regulatory Commission (“FERC”) in February 2009; and
- An Ancillary Services Must-Offer Obligation (“A/S MOO”) proposal that the CAISO will file with the Federal Energy Regulatory Commission (“FERC”) in conjunction with its SCP proposal.

I. THE CAISO’S STANDARD RESOURCE ADEQUACY CAPACITY PRODUCT PROPOSAL

The RA program was implemented to ensure that adequate resources would be available to serve load, meet appropriate reserve requirements, and

support reliable operation of the CAISO Controlled Grid. As the RA program has evolved, participants have identified a need to develop a standardized capacity product to facilitate the selling, buying and trading of capacity to meet RA requirements. A standardized capacity product with appropriate availability requirements and incentives for RA resources would also enhance the ability of the CAISO to ensure reliable grid operations. Stakeholders have affirmed to the CAISO that their ability to efficiently transact RA contracts is hindered by the current approach that requires negotiating agreements between parties without a standard product definition for trade. The need to address this matter was highlighted during the CAISO's Market Initiatives Roadmap process in 2008 where the Standard RA Capacity Product was ranked the highest priority out of a list of over 70 initiatives.

At the request of stakeholders, the CAISO in summer 2008 initiated a stakeholder process to design a Standard Capacity Product ("SCP") that would augment the RA program by establishing a standardized product to facilitate bilateral contracting for RA capacity and further enhance reliable CAISO grid operations. The CAISO is attaching hereto its current draft SCP proposal that has resulted from that process. This proposal will be circulated to stakeholders, and the CAISO will hold an additional conference call with stakeholders to discuss the proposal. Thereafter, CAISO staff will submit a proposal to management for review. A final proposal will then be submitted to the CAISO Board of Governors for approval at the February 2009 Board meeting. If

approved, the CAISO will submit a tariff filing to the Federal Energy Regulatory Commission (“FERC”) in February seeking approval of such SCP Proposal.

Under the CAISO’s SCP proposal, most of the existing RA process will not be changed. The SCP proposal can be summarized as follows, with additional details provided in the attachment:

- Availability Standard. If a resource receives payments for providing RA capacity, there is an expectation that the full RA capacity of that resource will be available to the CAISO, *i.e.*, the resource is not on a forced equipment outage or derate that diminishes its ability to provide the full amount of its RA capacity. Under the SCP, hourly resource availability will be tracked on a monthly basis and compared against a single availability standard or target based on the historic performance of the RA resource fleet during the peak hours of each month of the previous year.
- Availability Incentives. The SCP proposal will provide incentives for each resource to meet or exceed the target availability standard. On a monthly basis the CAISO will assess financial penalties to resources whose availability falls short of the target, and will provide bonus payments to resources whose availability exceeds the target. Bonus payments will be funded only through available financial penalty revenues. This will ensure that the mechanism is revenue neutral on a monthly basis and does not depend on revenues from other sources.
- Unit Substitution. A resource owner will be able to substitute a non-RA resource for an RA resource on forced outage in order to avoid the outage being counted against the RA resource’s availability. A pre-approval process will be required to ensure that the replacement capacity is comparable to the original RA capacity in an operational sense.
- Transition to SCP. The SCP has provisions for the grandfathering of existing RA contracts that have availability standards and incentives comparable to those specified in the SCP tariff language. Such grandfathered contracts would be exempt from the CAISO-enforced availability standards and incentives under the SCP. Upon the expiration of such contracts, any grandfathering would cease.
- Deferment of SCP availability standards and incentives for certain RA resource types. The CAISO proposal would not initially apply the SCP availability provisions to intermittent renewable generation (wind and solar), Qualifying Facilities (“QFs”), and demand response resources. The

CAISO intends to revisit the applicability of the SCP provisions to these resource types at a later date.

The CAISO believes that implementing an SCP will be a step forward in enhancing the benefits of and streamlining California's RA program, which is the Commission's goal in this proceeding.

II. PROPOSAL FOR AN ANCILLARY SERVICES MUST OFFER OBLIGATION

In connection with its FERC tariff filing in February to implement the SCP proposal, the CAISO will also propose to further enhance the effectiveness of the RA program by adding an Ancillary Services Must Offer Obligation ("A/S MOO") for RA capacity in the day-ahead Integrated Forward Market ("IFM") under the Market Redesign and Technology Upgrade ("MRTU"). For the reasons set forth below, the CAISO requests that the CPUC support adoption of the A/S MOO, as described herein.

Under the current MRTU Tariff, RA resources (except units on an outage and certain Use Limited Resources) have an obligation to submit in the IFM either self-schedules or economic bids for all of their RA capacity. This obligation is referred to as the Resource Adequacy Must Offer Obligation ("RA MOO"). In the CAISO's February FERC filing, the CAISO will propose to modify the RA offer obligation to require those RA resources subject to the RA MOO to submit in the IFM both (a) Economic Energy Bids and/or Self-Schedules for all of their RA Capacity and (b) A/S bids and/or Self-Provided Ancillary Services for all of their A/S certified RA capacity. This will allow the IFM to co-optimize the use of RA capacity that is subject to the RA MOO to provide Energy, A/S or a combination

of both, in accordance with the RA resource's physical capability (*i.e.*, to the extent the RA resource is certified to provide A/S), and thereby to make most efficient use of the available RA capacity.

The specific features of the A/S MOO are as follows:

- 1) All RA resources subject to the RA MOO must submit in the IFM a combination of (a) Economic Energy Bids and/or Self-Schedules for all of their RA Capacity and (b) A/S bids and/or Self-Provided Ancillary Services for all of their A/S certified RA capacity and for each service for which the resource is certified.
- 2) If an RA resource subject to the RA MOO fails to submit A/S bids for RA capacity that is certified and physically capable of providing A/S, the CAISO will insert default A/S capacity bids at the price of \$0 per MW-hour for each A/S for which the resource is certified. (This is analogous to the existing provision of the RA MOO under MRTU that authorizes the CAISO to insert Default Energy Bids for an RA resource that fails to submit energy bids or self-schedules for the full amount of its subject RA capacity.)
- 3) All RA resources with A/S certified capacity, with the exceptions as discussed below, will be considered for energy and A/S in the IFM energy and A/S co-optimization.
- 4) The CAISO will honor RA capacity energy self-schedules unless it is unable to procure 100% of its A/S requirements in the IFM. In such cases, the CAISO would be able to curtail the energy self-schedule or portion thereof, with the exceptions as discussed below, to allow certified A/S capacity to be used for A/S.
- 5) Hydro RA resources that offer economic bids for energy to the IFM should submit A/S bids, together with their energy bids, for all their certified A/S capacity commensurate with their economic bids for energy. Hydro RA resources submitting energy self-schedules will not be required to offer A/S in the IFM for their RA capacity that is self-scheduled to provide energy.
- 6) Non-Dispatchable Use Limited RA Resources will be exempted from the IFM A/S MOO.

Under the existing market structure, the CAISO decides which resources will be used for A/S, including regulation, spin and non-spin operating reserves, through an A/S market structure that is separate from energy scheduling and

dispatch decisions. Segregating the procurement of A/S from energy can lead to a less than optimal deployment of generating capacity. MRTU addresses this deficiency in the CAISO's current market structure by creating an IFM in the day-ahead timeframe and by co-optimizing the procurement of energy and A/S in both the IFM and, to the extent additional A/S are needed, in the Real-Time Market. Co-optimization results in a more efficient and, therefore, lower cost mix of resources to meet customer demand and system reliability needs. However, the benefits of co-optimization of A/S and energy will be severely undercut if the RA MOO under MRTU is not explicitly extended to cover A/S for which the RA capacity is certified.

Further, under MRTU, the CAISO is required to procure 100% of its forecasted Real-Time A/S requirements in the IFM. If the RA offer obligation is limited to Energy, the CAISO could find itself in a position where it has more energy bids than it needs but insufficient A/S supply being offered to meet the applicable Minimum Operating Reserve Criteria ("MORC"), even though there is more than enough available RA capacity to provide those A/S. That could put the CAISO in the precarious position of being unable to meet its A/S requirements fully in the IFM, which could cause A/S prices to increase significantly and unnecessarily. Moreover, once the CAISO implements "scarcity pricing," which FERC has directed the CAISO to implement within a year after MRTU go-live,

A/S withholding could trigger scarcity pricing events more often than would otherwise occur without an RA A/S offer obligation.¹

An A/S MOO would not impose any additional burden or costs on Load Serving Entities (“LSEs”) or suppliers of RA capacity. If an LSE is paying for the capacity of a resource under a bilateral RA contract or through a centralized capacity market, the AS MOO would enable the LSE to obtain all of the capacity services that the resource is capable of providing from the capacity that the LSE has purchased, not just energy, and would prevent the supplier of that capacity from meeting its RA offer obligation in such a manner as to create artificial scarcity of A/S supply. Through the IFM co-optimization process, the CAISO will determine how much it needs of energy or A/S from the procured RA capacity.

The CAISO emphasizes that its A/S MOO proposal *does not* impose any additional procurement obligation on LSEs, either in terms of an aggregate capacity requirement or the composition of their RA portfolio to include an explicit mix of A/S certified resources. Nor does the A/S MOO proposal extend the RA MOO to any RA resources that are not already subject to the RA MOO. Rather, the proposal is simply limited to ensuring that RA resources procured by LSEs for the purpose of complying with their Commission-established RA obligation that happen also to be certified to provide A/S also make their A/S capacity available to the CAISO.

¹ Scarcity Pricing is a mechanism that causes the market A/S prices to rise automatically, potentially beyond any applicable bid cap, when there is a shortage of A/S supply in the market. FERC directed the CAISO to file tariff language and to implement a reserve shortage Scarcity Pricing mechanism within 12 months after MRTU startup as part of its September 21 MRTU Order. *California Independent System Operator Corporation*, 116 FERC ¶ 61,274, Ordering Paragraph V (2006).

Similarly, suppliers of RA capacity should be financially indifferent to complying with the A/S MOO. At the Commission's March 30, 2008 workshop in Rulemaking 08-01-025, the CAISO presented an analysis demonstrating that RA resources can use bidding strategies to reflect preferences between energy and A/S that result in revenue at least equivalent to, and potentially greater than, resources submitting only energy bids. A copy of the CAISO's analysis is attached hereto. As a result, an A/S MOO will not trigger additional supplier costs that must either be passed through to LSEs or absorbed as a loss to suppliers. Thus, an A/S offer obligation may be imposed on all existing RA contracts that are subject to the current MRTU RA MOO without undermining the balance of benefits and burdens of the RA contracts.

In conclusion, the CAISO requests that the Commission support a requirement that resources offering RA capacity that can provide A/S make those products available to the CAISO in the MRTU Day-Ahead Market. This obligation would require RA capacity to submit A/S and energy bids for co-optimization into the CAISO's IFM. It is important to note that by imposing such obligation on suppliers of RA capacity, the CAISO is not in any way suggesting that there is any new or additional obligation of LSEs to procure A/S-capable capacity to meet their RA requirements. Nor is the CAISO advocating that the RA portfolio has to change in any way.

III. CONCLUSION

The CAISO respectfully requests that the Commission adopt the RA proposals described herein.

Respectfully submitted,

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Attachments

CERTIFICATE OF SERVICE

I hereby certify that on January 9, 2009, I served, by electronic mail and United States mail, a copy of Phase II Proposals of the California Independent System Operator Corporation to each party in Docket No. R.08-01-025.

Executed on January 9, 2009 at
Folsom, California

/s/ Anna Pascuzzo //

Anna Pascuzzo,
An Employee of the California
Independent System Operator