

**ATTACHMENT B**



# Memorandum

To: ISO Board of Governors  
From: Deborah Le Vine, Director of Contracts  
Brian Theaker, Manager of Reliability Contracts  
CC: ISO Officers  
Date: March 20, 2001  
Re: **Summer Reliability Generation Cost Recovery**

---

***This Memorandum requires Board action.***

## EXECUTIVE SUMMARY

The ISO is currently working with the State to allow the California Department of Water Resources ("CDWR") to take over the Summer Reliability Agreements ("SRAs") that the ISO executed last fall. However, if the State cannot successfully negotiate new agreements with the peaking generators, the ISO will be required to honor the SRAs it had previously executed. Thus, as a precautionary measure, the cost allocation for these contracts must be approved by the Board.

In the fall of 2000, the Board authorized Management to pursue and enter into SRAs with projects that responded to the ISO's August 24, 2000 Request for Bids for Summer Reliability Generation (the "RFB"). The Board deferred discussion of the cost recovery allocation to be used by the ISO in connection with such Agreements to its scheduled October 26<sup>th</sup> Meeting. At that meeting, Management recommended allocating SRA costs to metered Demand because the program primarily provided system-wide reliability. The Board requested that Management review cost allocation proposals from stakeholders and bring the issue back to the Board. While Management received two such proposals, Management believes that they do not meet the intent of the program and Management therefore recommends the following motion:

***Moved,***

***that the Board direct Management to recover costs incurred under Summer Reliability Agreements in the manner provided in Section 2.3.5.1.8 of the ISO Tariff – i.e. costs associated with each hour of the Summer Period (June 1 – October 31) "shall be charged to each Scheduling Coordinator pro rata based upon the same proportion as the Scheduling Coordinator's metered hourly Demand (including exports) bears to the total metered hourly Demand (including exports) served in that hour."***

## ISSUE STATEMENT

The Summer Reliability program was initiated by the ISO to meet the projected reliability needs of the ISO Controlled Grid for the coming summers. The SRAs executed by the ISO as part of the Summer Reliability program allow the ISO to dispatch the capacity that was constructed under this program up to 500 hours during super-peak

periods in the summer. In return the generator was given a "capacity reservation" payment for building the unit. The ISO is not entitled to the energy output of the unit and therefore the energy produced by these generators may not be sold into the ISO's Imbalance Energy market and therefore may not be serving the underscheduled load that shows up in real-time. By assuring the construction of this new unit, the Summer Reliability program provides reliability to the entire ISO Control Area.

The ISO expects to incur significant costs under the SRAs for the peaking capacity dispatch rights that the agreements will provide during summer periods. If CDWR does not replace the ISO's SRAs, the ISO's SRA costs could reach \$221 million.<sup>1</sup> Since these costs will be incurred outside of the energy and Ancillary Services markets administered by the ISO, they cannot be recovered through the ISO's market settlement and billing mechanisms. The issue addressed in this memo is how such costs should be recovered by the ISO.

Two proposals received from stakeholders consisted of 1) charging 100% of the SRA costs to underscheduled load that shows up in real-time; and 2) charging 50% of the SRA costs to underscheduled load and 50% to metered Demand. Both of these proposals miss the point of the program - to encourage the construction of a new reliability product that improves system-wide reliability. The ISO has determined that it requires additional generation to bring the ISO Controlled Grid into compliance with the Applicable Reliability Criteria during peak periods. The Summer Reliability Generation Request for Bids solicited proposals for generation resources to address a resource deficiency that exists in the ISO Control Area during summer peak periods. Management's recommendation (Option 1) is based on the primary purpose to be served by the SRAs. This program's purpose is identical to that of the ISO's Summer 2000 Demand Relief Program, and is based on the same Tariff authority (ISO Tariff Section 2.3.5.1). The cost recovery mechanism contained in ISO Tariff Section 2.3.5.1.8 was approved by the Board, and filed with and accepted by FERC, to provide for the ISO's recovery of costs associated with contracts entered into by the ISO for such reliability purposes and under such authority from all Scheduling Coordinators.

## **OPTIONS TO SOLVE PROBLEM OR DEAL WITH THE ISSUE**

- Option 1** Allocate the Summer Reliability Agreement costs to each Scheduling Coordinator *pro rata* based upon the same proportion as the Scheduling Coordinator's metered hourly Demand (including exports) bears to the total metered hourly Demand (including exports) served in that hour as provided in ISO Tariff Section 2.3.5.1.8.
- Option 2** Allocate the Summer Reliability Agreement costs to Scheduling Coordinators whose forward schedules, both generation and load, do not equal their actual real-time generation and load as provided in ISO Tariff Section 2.3.5.1.9.

## **ATTRIBUTES FOR COMPARING OPTIONS PROS AND CONS OF EACH OPTION**

### **Option 1 – Allocate costs as provided in ISO Tariff Section 2.3.5.1.8.**

---

<sup>1</sup> Since the last Board meeting, the ISO has received an additional executed contract for 44 MW.

**Pro:** The SRA reliability product was specifically designed to address an ISO system-wide resource deficiency due to not meeting the Applicable Reliability Criteria during peak hours in summer periods. The SRAs benefit the entire ISO Control Area and their costs should be paid by the entire Control Area.

ISO Tariff provisions are in place. No FERC filing is required.

**Con:** Allocates costs to all Scheduling Coordinators, even though they or their clients may individually have adequate generation resource portfolios to serve their peak load. This allocation method may also (in comparison with other options) reduce incentives for Scheduling Coordinators to remedy the generation shortage, which could require the ISO to procure peaking capacity for the long-term.

**Option 2 - Allocate costs to Scheduling Coordinators whose forward schedules do not equal their actual real-time generation and demands.**

**Pro:** Under this option, SRA costs would be allocated in a manner that "encourages" all Scheduling Coordinators and Utility Distribution Companies that have the responsibility for procuring sufficient generation to meet their peaking needs to make the arrangements necessary to cover their Loads, including arrangements with new generators, by assigning the costs to those that do not make such arrangements.

ISO Tariff provisions are in place. No FERC filing is required.

**Con:** A system-wide inadequacy of generation resources during summer peak periods drives the need for the SRAs, not underscheduling of loads or overscheduling generation by Scheduling Coordinators. This allocation method could also result in Scheduling Coordinators' paying more for forward arrangements. Additionally, this allocation methodology penalizes Scheduling Coordinators for deviations that may result from forced generator outages instead of intentional underscheduling. Such penalties may be incurred by the State, as it is the largest procurer of generation to meet system-wide needs.

## **POSITIONS OF THE PARTIES**

Management presented its recommendation to stakeholders at the September 19, 2000 Market Issues Forum. While several participants asked questions about the recommendation, no objection was voiced. Management subsequently included the recommendation in its Memorandum on the Summer Reliability Generation Requests for Bids included in the October 4<sup>th</sup> Board Meeting Materials. At the October 4<sup>th</sup> Board Meeting, a request was made to defer consideration of Management's recommendation until the next Board Meeting.

At the October 4<sup>th</sup> Board Meeting, it was noted that, in some cases, the service to be provided by generators under Summer Reliability Agreements will also provide local area reliability benefits. The availability of such benefits will depend on where the generation is sited. In those instances where the generation is sited within an area having local area reliability requirements not satisfied by Reliability Must-Run ("RMR") contracts (such as the San Francisco Greater Bay Area), the summer reliability generators will help meet such requirements. However, the benefit provided is different than that provided by RMR contracts since these units will be available only 500 hours

during summer peak hours. For this reason Management concluded that it would be inappropriate to allocate the costs of SRA the same way as the cost of the RMR contracts are allocated (i.e. to Participating TOs).

At the October 4<sup>th</sup> Board Meeting, it was suggested that Option 1 would inappropriately place the burden of SRA costs on those Market Participants that individually possess, or have made arrangements for, sufficient summer peaking capacity resources to meet their individual loads. It was further suggested that the cost recovery mechanism contained in the ISO's proposed Option 2 may be a preferable alternative.

At the October 26<sup>th</sup> Board Meeting, concerns were raised by the municipal utilities that they had already made arrangements for generation to serve their loads and should not have to pay the costs incurred by the ISO to maintain system reliability.

At the February 15, 2001 Board meeting, the California Municipal Utilities Association representative raised the same issue - that the municipal utilities had already procured resources to meet the needs of their loads and should not have to bear the cost of this program. However, this program is meant to improve grid reliability through new generating capacity; it does not provide for energy to supply load. One of the projects proposed to the State is a municipal generator that will presumably supply the municipal load.

#### **MANAGEMENT RECOMMENDATION**

Management recommends that the costs incurred under Summer Reliability Agreements be recovered from Scheduling Coordinators in the manner provided in Section 2.3.5.1.8 of the ISO Tariff (Option 1). Management advises against Option 2, as the Summer Reliability program costs would be incurred by the ISO for a different purpose than the cost methodology addressed in Section 2.3.5.1.9 of the ISO Tariff namely, to provide, through forward contracts, real-time reliability protection against the effects of persistent underscheduling of demand and generation in the forward schedules of Scheduling Coordinators. Under the SRA, the costs to be incurred by the ISO would relate to a system-wide resource deficiency, not the scheduling behavior of one or more Scheduling Coordinators.