

# Comments of CFCMA to CAISO Standard Capacity Product DRAFT FINAL PROPOSAL

Submitted by	Company	Date Submitted
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This document presents the comments of the California Forward Capacity Market Advocates (“CFCMA”) on the CAISO’s Draft Final Proposal (“Proposal”) of the Standard Resource Adequacy Capacity Product (“SCP”) of January 8, 2009. CFCMA is composed of five member companies: NextEra Energy Resources (formerly FPL Energy), NRG Energy, Reliant Energy, San Diego Gas & Electric Company, and Southern California Edison Company.

CFCMA appreciates the thoughtful work of the CAISO staff to evolve the earlier proposals into the current form. Overall, the Draft Final Proposal lays out a vision of the SCP that CFCMA believes can achieve the objective of facilitating RA compliance while meeting CAISO grid reliability needs. We appreciate this opportunity to express concerns about some issues that remain.

CFCMA’s concerns are primarily on two issues: the details of the availability incentive structure, and the provisions for grandfathering RA contracts. We also flag two areas of the Proposal for clarification by the CAISO, regarding the AS MOO and unit substitution.

## Availability Incentives

### *Nomenclature*

Strictly as a matter of optics, we urge the CAISO to shift away from the terms “penalty” and “bonus” towards a more neutral “availability charges and credits.” The term “penalty” carries a strongly pejorative connotation that, we believe, is not intended or appropriate.

### *Monthly vs. Annual Accounting*

The Proposal states that “financial penalty charge funds and potential bonus payments ... each month would be treated separately from other months, with its own ‘account’ of financial penalty funds collected and potential bonus payments going out (to the extent such funds are available) to the RA resources that exceed the target availability.”<sup>1</sup> The Proposal also states that “[t]he payment will be made as part of the first feasible settlement statement after the ISO has received payment on the

<sup>1</sup> Proposal at 22.

assessed penalties.” These two appear to be related: under a “pay when paid” approach, the risk of non-payment is being assigned specifically to those resources eligible for an availability incentive credit.

CFCMA believes that this is the wrong approach and, moreover, pursuing this approach creates market design issues with the SCP.

The Proposal correctly observes that the SCP availability charges should be subject to the general CAISO credit policy.<sup>2</sup> Consequently, collection of these charges is no more or less risky than collection of energy payments or any other charge assessed by CAISO. There is no reason, therefore, to provide for what amounts to a completely distinct credit policy regarding potential non-payment of availability charges, an implicit policy that shifts the default risk to a (potentially small) subset of suppliers.

Other issues are created by clearing the accounts separately for each month. First, CAISO proposes to use the same availability target in all months, based on historical annual averages. CFCMA supports this approach, but we are concerned that there may be seasonality within that annual average. Suppose in the extreme that resource availability has always been 100% from June through August but 80% in all other months. If each month clears on its own account, however, there would be no funds to reward the above-average performance during June through August, but there would be substantial availability charges rebated to load during the other months. The availability charges and credits would not, therefore, net out to be revenue neutral (in expectation, in aggregate) for the RA fleet.

A similar issue arises from the cap on the availability credit payments. CFCMA supports the Proposal’s use of such a cap: the value of a credit (in \$/MW) should be capped based on a multiple of the deemed capacity value so as not to turn the availability system into the “lottery” referred to by Prof. Wolack. The practical effect of the cap combined with the distinct monthly accounts, however, is to create a negative bias in the expected availability charges/credits, even if there is no seasonal variation in the fleet availability. Because outages are random, we can be sure that there will be some months with more outages than others and, likewise, some months with more above-average availability than others. If each month has its own account, months with randomly higher outages will create revenue surpluses, while months with randomly higher availability will create revenue deficiencies (relative to full funding of availability credits). Unless months with surpluses can be used to balance months with deficiencies, suppliers in aggregate will expect that availability credits will not be fully funded. This asymmetry in the design is not economically justified, as Prof. Bushnell pointed out at the MSC meeting.

The fix to this problem is, fortunately, simple: The CAISO should create *annual* ‘accounts’ for availability credits and charges, rather than monthly accounts. A surplus in January would be carried forward and available to fund availability credits earned later in that year. There are some details to work through from such a system; for example, would a deficit in February be allowed to draw down the full surplus created in January, or would there be year-end disbursement? (We would favor the former.) Overall, though, we believe that this structure solves the issues discussed above created by using distinct monthly accounts.

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<sup>2</sup> Proposal at 26.

### ***Application of Penalties to ICPM Payments***

On a different issue related to the availability incentives, CFCMA believes that, if a unit's lack of availability leads CAISO to secure additional capacity through the ICPM program, then the availability charges collected from that unit should first go to defray the ICPM cost.

### ***Forced Outages and Ambient Derates***

The CAISO states that although outages submitted using 'Ambient Cards' will not be classified in SLIC as forced outages, these outages will be counted against the hourly availability of the resource under the SCP availability standard.<sup>3</sup> It would be helpful if the ISO can further discuss this proposal with participants. The main question is that since availability will be assessed based on forced outages, should ambient derates that are consistent with a unit's fundamental engineering count against its availability score? Or are these intrinsic derates already reflected adequately in a resource's NQC and in the Planning Reserve Margin?

### **Transition and Grandfathering**

CFCMA appreciates that CAISO has put forward a concrete proposal for grandfathering RA contracts into the new SCP regime. We are very concerned, however, that the Proposal would have significant implications on existing RA contracts, potentially requiring widespread contract renegotiation.

Many RA resources are already under long-term contracts with LSEs, and these contracts meet the current RA standards established by the CPUC or other LRA. Given that they do currently meet an RA standard, these contracts should continue to satisfy the RA requirements of the contracting LSEs for the initial duration of the contracts. The current RA standard could not reasonably be said to be "equal" or even "equivalent" to the new SCP standards; few RA contracts provide any premium for above-target performance, and it is likely that none uses a peak-hour metric. Consequently, CAISO's Proposal to allow grandfathering of existing contracts only if they have "incentives ... at least equal to the requirements set forth in the SCP tariff"<sup>4</sup> has the potential to exclude all existing RA contracts. This is simply not reasonable and will cause substantial economic and commercial harm.

Grandfathering should be contract specific and not extended to contract renewals (either negotiated or evergreen), a point not explicitly addressed in the Proposal. We disagree with Mirant that grandfathering should be extended through all "optional extensions" of an existing RA contract, because that accommodation will perpetuate grandfathering longer than reasonably necessary to accommodate existing contracts.

CAISO has incorporated a suggestion made in prior comments of NRG, Reliant, and SDG&E that would make non-standard, grandfathered capacity not tradable. If CAISO requires that all non-standard capacity have "equal" or even "comparable" availability standards, though, this prohibition on trading is not sensible. Even if, for the reasons discussed above, CAISO eliminates this "equal" requirement for

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<sup>3</sup> January 8 SCP proposal page 17 and 19.

<sup>4</sup> Proposal at 27.

grandfathered contracts, the prohibition on trading this capacity may cause unintended issues in load pockets. In some load pockets, effectively all the existing capacity is under contract to LSEs. An absolute prohibition on trading any of this capacity would stymie competitive retail supply. Furthermore, the CPUC has from time to time required a utility to reduce its RA position in a load pocket; short-term sales from contracted capacity are, in this case, the only available option.

### **AS MOO Exceptions for Hydro**

CFCMA would appreciate further clarification from CAISO as to the partial exemption of hydro resources from the AS MOO requirement implied by this statement in the Proposal:

4) Due to various restrictions of operating conditions, hydro RA resources that offer energy bids should submit AS bids, together with their energy bids, in the day-ahead market for all their available AS capacity based on the expected available energy. Hydro RA units submitting energy self-schedules will not be required to offer AS in the DAM for the RA capacity corresponding to their energy self-schedules.<sup>5</sup>

Examples would help us to understand whether this exemption is appropriately crafted. Additionally, the CAISO should clarify that unavailability of a certified Ancillary Service does not lead to a reduction in availability for the calculation of availability charges and credits. For example, the fact that a unit certified to provide Regulation is unable to operate on Automatic Generation Control would have no impact on availability charges and credits, so long as no forced outage or derate limited the available dispatchable capacity to less than the MWs of contracted Resource Adequacy. This treatment is appropriate inasmuch as RA resources that *can* provide ancillary services (normally) are not directly compensated for this capability through their RA contract; although they are paid for ancillary services actually scheduled, there is no incremental *capacity* payment to RA-capable resources (unlike, for example, New England resources that are committed seasonally through that ISO's Locational Forward Reserves Market).

### **Unit Substitution**

The draft final proposal briefly introduces the concept of unit substitution, but additional information and examples would be useful. CFCMA is concerned that the proposal imposes requirements on replacement capacity that did not exist in the initial qualification. The standard should be the same; namely, if an LSE had submitted the slate of resources *with* the substitution at the beginning of the month (rather than the slate it actually relied upon), would it have met the Resource Adequacy requirements? Within this framework, for example, it would seem that any Eligible Capacity on a qualified substitute unit (e.g., a unit that has an RA obligation on only a portion of its NQC) should be eligible to be offered as a substitute for an RA resource that is on a forced outage, provided that the substitute resource is in the same Local Area as the unit being replaced (if applicable). Additionally, the CAISO must elaborate on what rules and criteria would be used by the CAISO in determining whether or not to approve a specific substitution request.

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<sup>5</sup> Proposal at 10, footnote omitted.