

Comments of CFCMA to CAISO Standard Capacity Product Revised STRAW PROPOSAL

Submitted by	Company	Date Submitted
Robert Stoddard RStoddard@crai.com +1 617 425 3195	California Forward Capacity Market Advocates (CFCMA)	December 18, 2008

This document presents the comments of the California Forward Capacity Market Advocates (“CFCMA”) on the Revised CAISO’s Straw Proposal (“Revised Proposal”) of the Standard Resource Adequacy Capacity Product (“SCP”) of December 4, 2008, as well as our reply comments to other parties’ comments on the earlier proposal. CFCMA is composed of five members companies: FPL Energy, NRG Energy, Reliant Energy, San Diego Gas & Electric Company (“SDG&E”), and Southern California Edison Company. CFCMA appreciates the thoughtful work behind the revisions to the Straw Proposal and this opportunity to provide further comments on the Standard Capacity Product development.

The Revised Proposal makes important strides towards a workable SCP definition by addressing two fatal flaws in the earlier draft. CFCMA supports the current draft’s use of an in-period financial incentive, rather than a lagging, physical de-rate penalty. We also view as essential the current position that there be a single, common availability standard to the fullest extent possible.

While we applaud CAISO’s work on these two areas, we remain concerned that CAISO has not locked down solid answers for several other important issues, most notably:

- Transition and grandfathering
- Testing
- Availability and outage reporting
- Definition of Peak Hours
- Demand-Side Resources
- Use in RA compliance
- Performance Incentives
- RA MOO rules

CFCMA remains very concerned that the scope of outstanding issues and details yet to be developed make the CAISO's proposed schedule extraordinarily aggressive; there simply is insufficient time to develop a workable, thorough and long-term SCP tariff filing that has been given careful scrutiny by market participants, including the CPUC. The SCP is critical regardless of the outcome of the CPUC's Phase 2 Track 2 proceeding (R.05-12-013), but it is essential that the CPUC and CAISO coordinate to develop a SCP that works for both entities. We expect that the SCP will be the quantum of traded RA product regardless of whether the CPUC adopts a bilateral or centralized mechanism. Furthermore, given the importance of California in the WECC market, the implications of a sound SCP design reach beyond CAISO's borders. We therefore strongly encourage the CAISO to take the time it needs to develop a comprehensive program that will work for the long-term rather than to cut corners that result in an incomplete proposal, leaving FERC to make decisions on undeveloped details or to send the proposal back to the CAISO for further refinement. Simply put, the CAISO should spend the time needed to get the details right so that parties contracting next year will have confidence that SCP is a stable, sensible standard.

Transition and Grandfathering

Some RA resources are already under long-term contracts with LSEs, and these contracts should continue to satisfy the RA requirements of the contracting LSEs for the initial duration of the contracts. Grandfathering should be contract specific and not extended to contract renewals (either negotiated or evergreen). 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.

An important question is what responsibilities under the CAISO tariff, if any, grandfathered resources should have. Clearly they should be subject to the current RA MOO requirement. We believe that they should also be subject to the AS MOO, as well. Also, the quantity of RA capacity under a contract should, in our view, conform with the NQC of the underlying resources, and the contracts' terms and conditions should not trump NQC counting rules.

Consequently, "grandfathering" would be limited to exempting these resources from the SCP performance incentives; these resources would not be subject to charges for below-target availability or for credits for above-target availability. CFCMA is concerned that subjecting these resources to SCP charges or credits would create duplicative and potentially conflicting performance metrics between the RA contract and the SCP tariff. Furthermore, because the performance incentive would be charged or credited to the resource's SC, it is not clear that the SC has any mechanism to pass these charges or credits through to the grandfathered RA resource. We would expect, under new RA contracts incorporating the SCP provisions, that such a pass-through mechanism would be included.

CFCMA urges CAISO to consider measures to minimize the potential abuse of the transition arrangements to exempt resources from the SCP framework. CAISO should recognize, however, that RA contracting should and will continue during the pendency of the SCP filing, and consequently should make reasonable accommodation for those contracts signed between now and SCP implementation.

Testing

The Revised Proposal still does not include any provision for regular testing of RA resources to ensure that the Pmax is accurate. CFCMA agrees with AReM on this point: “The CAISO tariff should contain explicit rules and protocols associated with annual (or seasonal) testing of capacity resources. Those tests should form the basis for a resource’s NQC that is then fixed for a year.”¹ Testing is essential to the integrity of the SCP and is standard practice in other RTOs. The testing need not be onerous; units that achieve Pmax during system operations would be deemed to have met their testing requirements. It is not unreasonable, however, for the CAISO to require that *all* RA resources demonstrate annually that they can achieve their stated Pmax. Testing is critical to assure that all resources are selling capacity based on a common metric for determining the actual ability of the unit to perform as well as to assure that any non-performance penalties are applied fairly and accurately.

Availability and Outage Reporting

CFCMA agrees with the Revised Proposal’s approach to define availability as periods when a resource is *not* on a forced outage owing to equipment failure. This approach correctly addresses the need for generation to take maintenance outages, as well as the fact that use-limited resources and intermittent resources will not be bidding their full capability into the market in every hour (but, instead, will be complying with the requirements of the RA MOO).

It is clear from CAISO’s statements during the MSC meeting, however, that the current SLIC reports are not sufficient for this task. Derates or outages reported through SLIC do not give CAISO enough information to determine whether the resource is unavailable due to equipment failure or for some other, excused reason. Currently, there are a number of circumstances where a resource owner may use SLIC to declare a unit partially or wholly unavailable for dispatch, even though the unit is “available” under the SCP definition: thermal resources with air credit limitations, wind generators without sufficient wind, or resources with forbidden generation regions. Rather than spending the resources to modify SLIC standards and to train staff on these new standards, CFCMA supports the view of the CPUC Staff, that CAISO should use GADS data for the purpose of measuring unit availability. Although SLIC data could be used as a one-year interim, we are concerned that CAISO would be needlessly investing in modifications to SLIC reporting to accommodate the SCP availability definition. These resources would be better spent moving straight to the end-state of using GADS data for all resources covered by GADS (which will shortly include wind resources). SLIC or self-reports would then be used only for a small fraction of RA resources.

Regardless of whether SLIC or GADS data are used to determine unit availability, CAISO should require *all* capacity resources to file conforming or equivalent data. No RA resource should be given a free pass on availability, which would be unduly discriminatory and could place system reliability at risk.

¹ Comments of the Alliance for Retail Energy Markets on the CAISO’s Straw Proposal Regarding a Standard RA Capacity Product, §5, page 2.

CFCMA notes that ICPM is intended to be a supplemental RA procurement, but that ICPM includes an availability metric that differs from what is under discussion now. CAISO should consider aligning ICPM's availability metric to be that of SCP.

CFCMA offered during the MSC meeting that the availability benchmark could be set using a three-year rolling average, using the latest 36 months of available outage data. In its comments, JPMorgan raised a concern that a continually changing target availability could create commercial contracting difficulties. The use of a three-year average will tend to stabilize the target, reducing those commercial risks.

Peak Hours

The Revised Proposal still includes an over-broad number of "peak hours" in the availability definition. The consequence, as Prof. Bushnell pointed out, is that the performance incentive in any one peak hour is diluted. With 1250 "peak" hours and a \$41/kW-year cost basis, the per-hour incentive is \$32.80/MWh.² This figure seems too small by an order of magnitude for non-performance during critical hours, but at the same time seems too large a charge to assess during periods of resource abundance.

Both Prof. Bushnell and PG&E suggested that some retrospective metric would be more appropriate. We disagree with any metric in which the number and distribution of peak hours is determined ex post. The SCP is fundamentally tied to the Planning Reserve Margin – that is, it is a forward-looking, planning concept. The PRM in turn builds in the expectation that a small fraction of resources will be unavailable even during peak periods. Placing a confiscatory charge on those resources that happen to be unavailable during a handful of peak hours creates unnecessary commercial risk and will raise consumer costs. Moreover, it seems unlikely to produce the same strong incentives for providing consistently high availability, because the odds of actually being able to avoid a charge through incremental improvements in maintenance and upkeep are fairly small if the charge is assessed in very few hours.

In our view, including several hundred pre-determined hours is the right balance. If CAISO selected 500 hours, the per-hour charge rate would be about \$80/MWh, which is substantial without being punitive. We agree with the MSC's view that these hours should be chosen based on some principled measure, such as those hours with greatest loss of load probability ("LOLP") historically.

Because RA is a monthly product, at least at present in California, we appreciate that CAISO has a legitimate interest in including *some* measurement hours in every month, perhaps as an all-hours metric that would complement a peak metric.³ Under this approach, which is similar to the availability metric of the CFCM design, the availability rate (\$41/kW-year) would be split between the two metrics with, for example, 80% "earned" during peak hours and the remaining 20% based on all-hours availability. This

² We note that there is an internal inconsistency with the CAISO's use of \$41/kW-year and a monthly rate of \$3.33/kW-month (approximately \$40/kW-year).

³ Concerns expressed by some parties that using two metrics could result in double penalties can be met easily by excluding peak hours from the "all"-hours metric or, limiting the application of such a metric to October through April, or more simply, by setting the penalty rate on peak hours very slightly lower to reflect the double counting. Since there is little science to choosing these penalty rates, however, there is no single best solution.

approach would put some weight on all months but focus the incentive on those months with greatest need for resources.

Demand-Side Resources

CFCMA generally agrees with the CPUC Staff comments regarding demand response (“DR”).⁴ We encourage the CAISO to work closely with the CPUC and its staff to work collaboratively in setting standards for DR performance and measurement so that DR can participate fully as SCP resources.

Use in RA Compliance

The CPUC’s Legal Division noted the potential that SCP tags may not be accepted by the CPUC as a means of demonstrating RA compliance. This reflects the importance of the two agencies collaborating to make SCP a sound product that fits the needs of both entities. CAISO needs to take the time, if necessary, to make sure that the CPUC and CPUC Staff are fully briefed and are supportive of the SCP filing prior to taking the proposal to FERC. If SCP tags do not serve the purpose of meeting the CPUC’s RA requirements, they serve no meaningful purpose at all. Leaving aside the transition issue of grandfathering contracts entered into prior to establishment of the SCP, CFCMA believes that there must be a one-for-one linkage between SCP tags and RA compliant MWs. That is, all resources granted SCP tags can be used to meet CPUC (and, hopefully, all California LRA) RA requirements, while at the same time no resources *not* granted tags could be used to meet RA requirements. We urge the CAISO and the CPUC to collaborate closely to ensure that this condition is likely to be met, taking additional time before filing with FERC if necessary.

Issues Raised by Other Stakeholders

The comments filed on November 24 by several other stakeholders raised some issues that CFCMA wishes to address.

Performance Incentives

BTG opposes the concept of paying bonuses for resources that perform above target, asserting that (1) “it could increase overall RA costs,” (2) “it is not clear where the CAISO will get the additional funds for such bonuses” and (3) “resources are already obligated to perform under their RA contracts, and will be compensated for such performance, which should be adequate incentive for performance.”⁵ We disagree and support the (near-) symmetric performance incentives included in the Revised Proposal.

The performance incentives, as CFCMA understands them, are self-funding and capped. Bonuses are paid out of availability charges collected, so there is no additional payment required from LSEs or consumers. Capping bonus payments at the charge rate (in \$/kW-year) prevents the system from becoming the “lottery” that Prof. Wollack raised; if availability charges exceed the amount required to

⁴ CPUC Staff Comments at pp. 4–5.

⁵ BTG Comments at p.3

fully fund the performance bonuses, the difference is to pay for ICPM procurement or returned LSEs *pro rata*.

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.

CAISO has proposed a deadband around the target availability. While CFCMA is not strongly opposed to such a deadband, we also do not see any particular reason for it. We have some concerns that any discontinuous incentive payment may create perverse incentives (or lack of incentives) for resource owners.

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.

We disagree that there is anything in the RA contracts that provides appropriate incentives for resources to always seek to improve their performance. The SCP performance standards will become the metric used in all RA contracts. If the SCP metric rewards 100%, 95%, and 90% availability identically, resources that can easily achieve 90% availability will have no financial incentive from their RA contracts to undertake performance improvement programs to achieve higher availability. Consequently, the fleet average availability will likely be lower, and the state will need to carry a higher installed capacity margin at the expense, in the end, of consumers. One way to solve this would be to set the standard at 100% and penalize *any* forced outage during a peak hour. This expected availability charges would be passed through in RA costs. We believe, therefore, that the proposed availability credit/charge system achieves a similar goal without imposing a premium cost on RA contracts. Moreover, including a potential for earning an availability credit provides an incentive for resources not to be grandfathered but move directly into the full SCP framework.

CAISO verbally altered the Revised Proposal during the MSC meeting to reflect the need for a credit requirement for RA resources subject to the SCP availability charges. We agree that all charges including penalties should be included in the CAISO's determination of estimated aggregate liability used to determine the financial security a participant is required to post, and look forward to reviewing any refinement of that process in the next iteration from CAISO.

AS MOO Exceptions for Hydro

PG&E, CMUA, and NCMA all press for expansive exemptions for hydro resource under the AS MOO. We join Dynegy in disagreeing.⁶ While the environmental and regulatory requirement around hydro plants must be respected, these requirements should not lead to the *carte blanche* exemption imbedded in the CAISO's proposal rule. Exemptions from RA MOO should be specific and limited. The burden should be on the resource owner to demonstrate why, on a given day, use of the resource for a particular ancillary service could lead to a violation of its water usage requirements, and the exemption should then be

⁶ Dynegy Comments at p.2.

limited to offering the particular classes of ancillary services that could lead to such violation. To the extent that an AS MOO exemption is required in a particular situation, CFCMA believes that such exemptions should be limited as to duration and rare as to quantity of resources exempted.

There are two situations where such a violation could occur: the resource may be asked to use too *much* water, or too *little* water.

Providing reserves does not use additional water unless the reserve is activated. The resource owner should designate these reserves as “contingency-only” and offer these reserves at a sufficiently high price to avoid frequent activation and to ensure the prompt dispatch of replacement reserves, but it should *not* be allowed to withhold reserves because of its proprietary economic interests. Recognizing that subject to ramping constraints (or an extreme reserve shortage) the system would be redispatched to promptly decrement this high-priced energy, it would seem a rare situation where a hydro owner could demonstrate that the expected water use from providing reserves would so deplete the reservoir that the resource would violate some regulatory requirement .

In the alternate situation where holding capacity in reserve would use too little water, *curtailing* an energy schedule so that the resource could provide operating reserves could violate minimum run requirements if such requirements are set hourly, but not if the requirement is daily or longer (because there would be other hours, later, in which the resource owner could make up for the reduced water flow). This situation is quite different than the scarcity pricing proceeding cited by PG&E, in which water use would be incrementally *higher* than the energy self-schedule. Again, we believe that there are few situations where a hydro owner can demonstrate that a temporary reduction in an energy schedule would lead to a potential violation of a regulatory requirement, but in those limited situations where that demonstration *can* be made, and only then, should the resource be exempt from RA MOO.

Furthermore, as we read it, the AS MOO exemption as proposed would allow a large resource not to offer *any* ancillary services even if a single megawatt of energy was self-scheduled from it. This is simply unreasonable. If a 400 MW resource is certified to provide 40 MW of regulation, and it has self-scheduled 300 MW of energy, then it should still be required to offer 40 MW of regulation (and any other ancillary services for which it is certified). This requirement should be both on all units, thermal or hydro.

CMUA raises a point to which CAISO should respond. CMUA states, “It is quite possible that the Energy and AS market prices will not converge either in times of scarcity or otherwise. As such, use of the self-scheduled unit in the AS market may expose the SC for the LSE to energy price risk, in contravention to the bid preference indicated by the Energy self-schedule.”⁷ Under the co-optimization of MRTU, this would *not* be the case for a unit with priced energy and AS offers; if the unit’s dispatch level was reduced so that the unit could carry reserves, the reserve price would, by construction, fully replace the lost energy profits. CAISO should ensure that AS price formation if self-scheduled energy is curtailed provides a similar assurance, which should address CMUA’s concern.

⁷ CMUA Comments at p. 3.