Memorandum

To: ISO Board of Governors

From: Keith Casey, Vice President, Market & Infrastructure Development

Date: October 25, 2017

Re: Decision on capacity procurement mechanism risk of retirement process enhancements

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This memorandum requires Board action.

EXECUTIVE SUMMARY

The ISO is authorized to procure critical resources that are at risk of retiring under its capacity procurement mechanism (CPM) if load serving entities have not procured such resources through their procurement programs. Resource owners have highlighted, among other concerns, that the current CPM process does not provide sufficient advance notification to meet their business needs to retire a facility. Under the current risk of retirement CPM process, resource owners will not know whether the ISO intends to procure them for the upcoming year until after completion of the annual resource adequacy procurement process (*i.e.*, October 31). Resource owners have asked the ISO to improve the designation process so the ISO can indicate its intent to designate a resource earlier in the year, thus providing resource owners with sufficient lead time to make significant decisions regarding retirement and major maintenance.

To address this concern, Management proposes to provide two windows each year wherein resource owners can request risk of retirement CPM designations. Both resource adequacy and non-resource adequacy resources may request a risk of retirement CPM designation during the two windows. This change will allow for the earlier notification resource owners have requested. Management also proposes market power protections and provisions to ensure the new process does not have adverse impacts on the resource adequacy market including: (1) requiring a resource owner to accept any risk of retirement CPM designation, and (2) compensating a resource based on its cost-of-service.

Management proposes the following motion:

Moved, that the ISO Board of Governors approves the proposal to enhance the* capacity procurement mechanism risk of retirement process *as described in the memorandum dated October 25, 2017; and

Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposed tariff change, as described in the memorandum dated October 25, 2017.

BACKGROUND

The ISO has authority to procure resources that are needed for reliability but are at risk of retirement. These retirements are often due to a resource's failure to earn sufficient revenues if it is not procured by a load serving entity for resource adequacy.

Resource owners have requested enhancements to the ISO's existing process because under it, they do not know until the end of the current year whether the ISO intends to procure them for the upcoming year. They indicated that this this provides insufficient time to make important business decisions regarding their units and that they need a longer "runway" so they can make important business decisions regarding whether to retire their resource earlier in the year.

Through the stakeholder process that commenced in May 2017, the ISO has strived to modify the CPM risk of retirement process to allow for conditional designations earlier in the year so resource owners can know sooner whether their resource is needed and will be procured, either through the resource adequacy process or under a CPM risk-of-retirement designation.

PROPOSAL

Management proposes the following enhancements to the ISO's CPM risk-of-retirement process:

- New language clarifying that any resource can request a designation, including a resource adequacy resource.

- A requirement that if the ISO designates a resource, the resource must accept the designation, except in a few limited circumstances. Management believes that this is appropriate because the resource voluntarily requested the designation, the ISO determined that the resource is needed for reliability, and the ISO will compensate the resource based on its full cost of service.

- Two windows each year during which resources can request a CPM risk-of-retirement designation. This will result in a more orderly and efficient process. Entertaining risk-of-retirement CPM requests earlier in the year will address resource owners' concerns about the need for a longer "runway" to make retirement and major maintenance decisions.

- Specific requirements that apply in the first request window to a resource requesting a designation for the upcoming resource adequacy year. These requirements address concerns that designations resulting from the first window will front-run the RA process. In particular, for a resource to receive a designation for the upcoming year it must be the only resource that addresses the reliability need. Because there are no alternative resources that can meet the reliability need, the process does not unduly interfere with RA procurement.

- A revised affidavit requirement that accommodates other reasonable circumstances in which a resource owner should not be required to retire the unit.

- A requirement that a designated resource must make a cost-of-service filing with the Federal Energy Regulatory Commission, and FERC will decide the resource's compensation based on its cost of service. Risk-of-retirement CPM decisions are inherently resource specific, and the competitive solicitation process does not apply to risk-of-retirement CPM designations. Designated units are essentially receiving a "bridge" payment until the year they are needed, and RMR-type pricing is more appropriate than market-based pricing in these circumstances.

POSITIONS OF THE PARTIES

Management balanced diverse stakeholder positions to arrive at this proposal. Stakeholders are split on their views of Management's proposal. Several stakeholders either support the proposal or do not oppose it. Others oppose it for various reasons. A stakeholder comments matrix is included as Attachment A, which describes stakeholders' positions. The Department of Market Monitoring provided supportive comments in its Market Monitoring Report, which is included in the informational reports of the November Board materials.

The CPUC and some load serving entities object to the first window because it could result in the ISO indicating its intent to designate a resource before completion of the year-ahead annual resource adequacy procurement process. They express concern that this will "front run" and impact prices in the resource adequacy bilateral contract market because the ISO will procure resources in lieu of such resources being procured in the resource adequacy market. On the other hand, resource owners believe that early notification is necessary to facilitate orderly and timely retirement and maintenance decisions. The following features of the ISO's proposal effectively mitigate any "front running" concerns: (1) for the ISO to indicate its intent to designate a resource for the upcoming year, the ISO must find that it cannot operate the grid reliably without that single resource in operation (*i.e.,* there cannot be multiple resources that meet the identified reliability need); (2) the resource will be compensated based on its cost-of-service; and (3) the resource must continue to seek a resource adequacy contract by participating in solicitations and requests for offerings/proposals until the time the ISO actually designates the unit. Management stresses that the ISO will designate the unit only if it is not procured through the resource adequacy process.

A second issue is the compensation to be paid to a designated resource. Management proposes to pay a cost-of-service based rate that FERC will determine. Load serving entities support this cost-based pricing, but resource owners advocate that the ISO allow resources to submit price offers up to the soft offer cap even if those prices exceed the resource's cost of service. Management finds that cost-based pricing is appropriate because CPM risk-of-retirement decisions typically will be based on unit specific needs, which are not amenable to competitive solicitations like the other categories of CPM. Also, a CPM risk-of-retirement designation is only intended as a bridge to a future date when the resource is needed for reliability and would be expected to be procured under the resource adequacy program. The proposed cost-based pricing is similar to the reliability must-run pricing structure that the ISO has used in recent years to procure other resources at risk of retirement.

Resource owners do not support mandatory acceptance of a risk-of-retirement designation and instead request that designations remain voluntary. Other stakeholders support having mandatory designations because the ISO has found the resource to be needed for reliability and is paying the resource its full annual cost of service. For the reasons discussed above, Management believes it is appropriate to require acceptance of a designation a resource owner has voluntarily requested, except under limited circumstances.

CONCLUSION

Management requests the ISO Board of Governors approve the incremental improvements to the capacity procurement mechanism risk-of-retirement process described above. The enhancements will provide the longer runway and earlier notification that resource owners have requested and support reliable grid operation through procurement of critically needed resources.

Attachment A

Stakeholder Process: Decision on Capacity Procurement Mechanism Risk of Retirement Process Enhancements

Summary of Submitted Comments

Stakeholders submitted four rounds of written comments to the ISO on the following dates:

- Round One, 6/6/17
- Round Two, 7/12/17
- Round Three, 8/28/17
- Round Four, 10/4/17

Stakeholder comments are posted at: http://www.caiso.com/Pages/documentsbygroup.aspx?GroupID=55D6490D-5F74-4266-9031-AB0E9B74DDE1

Other stakeholder efforts include:

- 5/18/17 stakeholder working group meeting on needs and issues
- 5/25/17 stakeholder working group meeting on potential solutions
- 6/27/17 stakeholder call on straw proposal
- 8/15/17 stakeholder call on revised straw proposal
- 9/20/17 stakeholder call on draft final proposal
- 10/19/17 posted addendum to draft final proposal

Position	Stakeholder	Comment
Support	DMM SCE	Proposed earlier designations make a more viable option for resources considering retirement and is an improvement over current process which occurs too late in year to be of practical use. (DMM) Several aspects reduce likelihood a resource will submit inefficient retirement requests. (DMM) • Cost-of-service compensation reduces potential for rent seeking compared to compensation at capacity procurement mechanism soft-offer cap. • Resource must attest in writing that it intends to retire, which increases difficulty of, and rewards from, fishing for designation payments. • Proposal allows a resource to not retire if it receives a resource adequacy contract; this flexibility allows resources that were uneconomic to stay in service when conditions change. Providing an April window does not create a fundamentally new way to front run the resource adequacy process as a resource currently can receive a reliability must-run agreement at any time of the year. Receiving compensation on a cost-of-service basis rather than soft-offer cap reduces concern that April window will undermine current resource adequacy process and market. (DMM) Concerns about designations occurring before resource adequacy process highlights need to change resource adequacy process timeline so that resource adequacy contracting is completed further in advance of operations. (DMM) Support clarification that resource adequacy crediting will be based on attributes of procured resource. (SCE) Support FERC being the entity that approves all costs, including amortized past expenses. (SCE)
Do not object (Calpine) Do not oppose (Six Cities)	Calpine Six Cities	ISO has made several helpful clarifications that improve the mechanism, but object to other aspects of the proposal such as mandatory acceptance, the cost of service framework, and the usefulness of the process to Calpine. (Calpine) Support elements that allow designation “for the balance of the calendar year,” striking tariff language that allows the discretion to designate resources from “one to twelve” months, and modifications to determination of price that would be paid. (Calpine) Request ISO specify the steps the ISO will take to ensure that commitments made in affidavit to retire are fulfilled in absence of a designation. (Six Cities)
Do Not Support	Cogentrix CPUC NRG	Providing an April window results in inappropriate front running of the resource adequacy process. It will negatively impact bilateral resource adequacy contacting because a resource that is eligible for a CPM designation would gain an unfair

Position	Stakeholder	Comment
	ORA PG&E SDG&E WPTF	advantage in contract negotiations with load serving entities, likely resulting in higher ratepayer costs. (CPUC, ORA, PG&E, SDG&E) Attestation requirement is not stringent enough to ensure that price discovery behavior will not occur in April window. (CPUC, ORA) Adding additional reasons for a generator to not have to retire lowers attestation burden on generator. Current Business Practice Manual language is critical to safeguarding ratepayer interests and must be reflected in proposal. (CPUC) Initiative does not address the use of reliability must-run agreement for resources as highlighted by reliability must-run agreement procurement in March 2017. (CPUC, ORA, PG&E, SDG&E) Do not support imposing a trigger price to be eligible for designation during the April window because it makes it unlikely the window will be used. (NRG, Cogentrix, WPTF) The timing of Type 3 procurement process for the November window needs to be improved to provide the ability for load serving entities to procure a potentially designated resource in their year-ahead resource adequacy showings in lieu of the ISO procuring the resource. (SDG&E) Proposed cost-of-service payment unnecessarily compensates resources needed in near-term and provides too high a level of compensation. (ORA) Proposal is for cost-of-service pricing, but FERC has clearly indicated its preference for market-based backstop mechanisms. (Cogentrix, WPTF) Believe there are issues with using the CPUC's 2016 Resource Adequacy Report for the price to be used as a trigger for being eligible to be studied because: (a) data could be misinterpreted as representing current resource adequacy market, which it does not; (b) there is no insight as to annual price trends in the data; (c) and it does not represent what generators receive on actual capacity basis. The trigger price for a resource in a local area is too high for resources to qualify to apply for a designation, which will create situations where ISO needs to use reliability-must-run agreement procurement instead of risk of retirement designation procurement. Although some companies are set up to find a cost-based rate such as a reliability-must-run agreement acceptable, other companies have different opportunities and should not be limited to a cost-based rate absent market power. (WPTF)

Position	Stakeholder	Comment
Management Response	To address concerns regarding the potential for front running the resource adequacy program, the ISO proposal includes two requirements for a resource that has applied for a designation for the upcoming year in the April window: (1) the ISO must find that it cannot reliably operate the grid without that single resource in operation, *i.e*., no other resource can meet the reliability need; and (2) the resource must continue to try to seek a resource adequacy contract by participating in solicitations and requests for offerings/proposals until the time the ISO actually designates the unit. Resource owners desire market-based compensation that would be higher than the cost-based compensation proposed by the ISO, and some stakeholders advocate for compensation lower than what Management is proposing (such as paying only cold layup mothball costs). Management supports cost-based pricing because it provides a capacity payment to keep a resource on-line for a period of time as a bridge to a future period when the resource will be needed for reliability. This type of cost-based pricing is similar to the pricing structure the ISO uses for reliability-must-run agreements, which the ISO has executed in recent years to procure other resources that were at risk of retirement. Although some resource owners support retaining the voluntary nature of risk-of-retirement CPM designations, Management believes that acceptance should be mandatory except in limited circumstances. The ISO is paying the resource its full annual cost of service and has found that the resource will be needed to meet reliability. On October 19, 2017, the ISO posted an addendum to its draft final proposal that includes three revisions to address the following stakeholder concerns discussed in the matrix above. First, the ISO revised the proposal to require that a resource submit a retirement plan within 60 days after being informed by the ISO that that the ISO will not designate the resource. This addresses a concern expressed by several stakeholders that there should be a mechanism to provide that a resource will retire within a certain period of time if the resource does not receive a designation. The addendum clarified that the ISO will post the names of the resources seeking a designation for both windows, and if there is a designation the ISO will give load serving entities until 14 days after the latter of the issuance of the study report or the annual resource adequacy deficiency report to procure resources. If the ISO does not issue a study report for that year, load serving entities will have until 30 days after issuance of the annual resource adequacy deficiency report to procure resources. Third, Management no longer proposes a trigger price for a resource to be eligible for a designation.