J.P. Morgan Comments on CAISO Straw Proposal on Standard Capacity Product II

Submitted by	Company	Date Submitted
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J.P. Morgan Ventures Energy Corporation and BE CA, LLC (collectively, "J.P. Morgan") appreciates this opportunity to provide comments on the California ISO's (CAISO's) January 19, 2010, Straw Proposal entitled Standard Capacity Product II ("Straw Proposal").

J.P. Morgan continues to support the development of a Standard Capacity Product that will support a liquid and active market for resource adequacy capacity. At this time, J.P. Morgan's comments focus on the CAISO's proposed "Replacement Rule." J.P. Morgan does not support the CAISO's Replacement Rule as currently described in the Straw Proposal. Absent further clarification and refinement by the CAISO, J.P. Morgan is concerned that the proposed Replacement Rule is potentially unworkable and would inappropriately place a large amount of unmanageable risk on suppliers of resource adequacy capacity. As described further below, J.P. Morgan recommends that the CAISO clarify and/or modify certain elements of the proposed Replacement Rule.

Background

Existing CPUC Replacement Rule

The California Public Utilities Commission's (CPUC's) existing resource adequacy program requires jurisdictional load service entities (LSEs) to make annual (year-ahead) and monthly (month-ahead) "showings" that they have procured sufficient capacity to satisfy the CPUC's planning reserve requirements. The annual showings are submitted in the October/November timeframe each year. The year-ahead showings must demonstrate that each LSE has procured capacity to satisfy 100% of their local requirements (based on a CAISO study and representing a static amount for each month). The annual showings also include a demonstration that each LSE has satisfied 90% of their system resource adequacy requirements. Importantly, the year-ahead showings for local and system do not reflect any scheduled outages. In other words, the identified local and system resources are presumed to be available 100% of the time through the year.

The monthly showings are characterized as system showings, with the purpose that LSEs show how they have satisfied 100% of their system resource adequacy requirements for the given month. The monthly showings, of course, include resources used to satisfy the local capacity requirements but which also count towards satisfying the broader system requirements. As understood by J.P, Morgan, it is in these monthly showings that LSEs indicate whether a resource is on a planned outage and where LSEs identify replacement capacity for those resources on a planned outage. However, as understood by J.P. Morgan, the current requirements do not require LSEs to replace local capacity on a scheduled outage with other local capacity. Moreover, it does not appear that the CAISO validates, on a month to month basis, that there is sufficient local capacity available (i.e., not on a planed outage) to satisfy the CAISO's requirements. In other words, while the CPUC's current replacement rule obligates LSEs to replace resource adequacy capacity that is out on a scheduled outage of a certain duration, the rules permit LSEs to replace *local* capacity on a scheduled outage with *system* capacity.[1]

CAISO Straw Proposal

Section 3.3 of the Straw Proposal provides the following context for the CAISO's proposal to modify the existing replacement rule:

> **3.3. Replacement Rule**
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> In the December 4th Issue Paper for SCP II, the topic of the replacement rule was discussed as being out of scope for this initiative. However due to the stakeholder comments on the issue as well as discussion in other forums, including the CPUC SCP workshop on December 14 and stakeholder proposals for the scope of Phase 1 of the RA OIR (R.09-10-032), the ISO has reconsidered that approach and decided to include the topic in the scope of the SCP II initiative.
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> In its proposal to the CPUC on January 11, the ISO stated that it does not oppose removing the replacement rule if its elimination does not adversely impact reliability in the ISO balancing authority area. To that end, the ISO proposes to work collaboratively with the CPUC to transition the treatment of schedule outages for RA purposes from the replacement rule to another approach which will maintain sufficient capacity to serve load and reliably operate the grid.

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[1] See the CPUC's *"2010 Filing Guide for System and Local Resource Adequacy (RA) Compliance Filings"* at pp.10-11.

Based on the comments received by stakeholders, including the CPUC, section 4.3 of the Straw Proposal outlines the CAISO's proposal for modifying the existing replacement rule:

> **4.3. Elimination of the CPUC's "Replacement Rule"**
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> In response to the suggestion that the CPUC eliminate the replacement rule in favor of an ISO solution, the ISO's straw proposal to address the planned outage issue is to provide a replacement obligation on suppliers of RA capacity in the ISO tariff, and implement a process that is similar to the current SCP unit substitution mechanism. Under this proposal, when an RA resource intends to take a planned outage in a particular month, the supplier will indicate the details of the intended outage in its supply plan submitted to the ISO and put a request into SLIC for a planned outage. The supplier will have the opportunity to replace the RA resource during the planned outage period with a non-RA resource in accordance with the same substitution rules already approved for unit substitution under SCP. If the substitute capacity submitted by the supplier is acceptable to the ISO then the supplier will have met its replacement requirement for that particular planned outage. If, however, the supplier does not offer acceptable replacement capacity to the ISO, the ISO may, based on anticipated system conditions or other operational considerations, (1) deny or reschedule the requested planned outage, (2) approve the requested outage and procure additional replacement capacity through the ICPM or whatever mechanism may replace ICPM in the future, or (3) approve the requested outage and not procure additional replacement capacity. If the ISO operators determine that (2) is the appropriate action for the situation, either in advance of or during the operating month, the ISO will allocate the cost of the replacement capacity to the supplier of the RA capacity on the planned outage.

<u>Comments</u>

J.P. Morgan is not opposed to the development of a revised resource adequacy replacement rule that places the obligation to replace resource adequacy capacity on a scheduled outage on suppliers of resources adequacy capacity. Currently, while the CPUC's rules place that obligation on LSEs, the obligation to replace resource adequacy capacity on a scheduled outage is often a term negotiated between an LSE and a supplier. J.P. Morgan agrees that specifying the obligation in the CAISO tariff will eliminate the need to negotiate these terms in each individual bilateral resource adequacy contract.

However, J.P. Morgan's concerns with the CAISO proposal are threefold.

The CAISO should exempt or "grandfather" existing resource adequacy contracts from the new replacement rule if those contracts already specify which party has the obligation to replace resource adequacy capacity out on a scheduled outage

First, the CAISO should clarify that the proposed provisions would not apply to those existing contracts where the obligation and terms of procuring replacement capacity are already detailed. In other words, the CAISO should specifically exempt or "grandfather" those existing bilateral resource contracts that already address the obligation to procure replacement capacity for resource adequacy on a scheduled outage. In its SCP I effort the CAISO recognized the need to grandfather certain contracts from the SCP availability standards and the CAISO should likewise recognize the need to do the same with respect to the SCP II replacement rule provisions.

The CAISO's Replacement Rule must not impose unreasonable risks on suppliers of resource adequacy capacity

Second, the CAISO should develop a going-forward replacement rule that appropriately balances the CAISO's need to ensure system reliability with the viability and practicality of procuring replacement capacity. The CPUC's existing resource adequacy program rules were established cognizant of the fact that LSEs may be limited in their ability to procure the requisite capacity, be it the capacity necessary to satisfy their core obligations or replacement capacity. For example, among other rules, the CPUC established a price trigger above which an LSE could request a waiver of its resource adequacy obligations.[2] In addition, in order to facilitate procurement of local capacity, the CPUC permitted the aggregation of certain CAISO-identified local areas in Pacific Gas & Electric Company's service area. In addition, based on the formula detailed in the CPUC's RA Guide, the CPUC permits resources on a scheduled outage to continue to count towards satisfying an LSEs resource adequacy obligations.[3] Finally, as noted above, the CPUC appears to permit LSEs to replace system or *local* capacity on scheduled outage with incremental available *system* capacity. To J.P. Morgan's knowledge, neither the CPUC nor the CAISO have raised concerns over the past several years that such rules have in any way compromised or threatened grid reliability. While J.P. Morgan supports the CAISO's existing tariff provisions that all scheduled outages be submitted to and approved by the CAISO, the obligation to replace that capacity should be tempered by both need (system reliability) and the practicality of securing replacement capacity.

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[2] The current CPUC waiver trigger is set at $40/kw-yr. Under the CPUC's rule, if an LSE receives bids to supply resource adequacy capacity that are in excess of the trigger price, the LSE can request a waiver of its resource adequacy obligations. J.P. Morgan acknowledges that the CAISO's proposal to charge suppliers the ICPM rate for replacement capacity also acts as a de facto price cap on replacement capacity.

[3] See the CPUC's *"2010 Filing Guide for System and Local Resource Adequacy (RA) Compliance Filings"* at p.11..

J.P. Morgan therefore recommends that the CAISO develop a replacement capacity obligation for resource adequacy suppliers that carefully balances the CAISO's need to ensure grid reliability with the ability of suppliers to secure adequate replacement capacity. J.P. Morgan is concerned that if the CAISO were to impose replacement capacity obligations similar to the requirements for unit substitution under the existing SCP I tariff provisions, suppliers would be potentially obligated to replace local capacity with other capacity from the same local area and perhaps capacity deemed "electrically equivalent" to the capacity on scheduled outage. While J.P. Morgan appreciates the CAISO's need to ensure that sufficient capacity is available to satisfy its local capacity and grid reliability needs, similar to the concerns previously expressed by LSEs before the CPUC, J.P. Morgan is concerned that there may not be sufficient non-resource adequacy replacement capacity available in a specific local area, let alone capacity that the CAISO views as electrically equivalent based on system conditions that exist at the time of a request for a scheduled outage. The CAISO's proposed replacement rule should not impose risks on resource adequacy capacity suppliers greater than those born today by LSEs under the CPUC's replacement rule.

Further clarification is needed regarding the process and mechanics of reviewing and approving scheduled outage requests and designating ICPM capacity

Finally, J.P. Morgan requests that the CAISO clarify and if necessary modify the process by which it may rely on its Interim Capacity Procurement Mechanism to designate what it views as necessary resource adequacy replacement capacity. The CAISO's current ICPM tariff provisions enable the CAISO to designate ICPM capacity in instances where individual LSEs are deficient in local or system capacity as detailed in their annual or monthly showings or where the CAISO has identified a need despite the fact that LSEs have satisfied the CAISO's minimum requirements in a local area. The existing ICPM tariff provisions also provide opportunities for LSEs to cure identified capacity deficiencies, either thirty days prior to a compliance year or ten days prior to a compliance month.

J.P. Morgan requests that the CAISO clarify and specify the timeline and mechanics of the process by which the CAISO will review monthly supply plan submissions, approve or disapprove requests for scheduled outages, and determine whether ICPM designations are warranted. J.P. Morgan is unclear as to whether the CAISO's proposed process will allow suppliers an opportunity to "cure" capacity deficiencies in instances where the CAISO has approved a requested scheduled outage but either not approved identified replacement capacity or has otherwise determined that a capacity deficiency exists. In addition, J.P. Morgan requests further clarification on the process by which the CAISO will allocate replacement capacity costs (ICPM) in instances where there are multiple requests to replace designated resource adequacy capacity (multiple outage requests) or where there exists both replacement capacity requests and LSE deficiencies. J.P. Morgan also requests that the CAISO provide further detail on the circumstances under which it may or may not designate ICPM capacity when a capacity deficiency exists. While J.P. Morgan understands that the CAISO's existing ICPM tariff provisions provide the CAISO with the discretion to not designate ICPM capacity in circumstances where a capacity deficiency exists, further clarification of the criteria the CAISO will employ to make such determinations is appropriate in light of the potential cost impact on suppliers from such decisions.

As outlined in the above comments, further clarification and refinement of the CAISO's proposed replacement rule is warranted prior to finalizing the SCP II proposal. J.P. Morgan appreciates the opportunity to provide these comments and looks forward to further discussions with the CAISO and stakeholders on the issues discussed herein.