

# Memorandum

**To:** ISO Board of Governors  
**From:** Eric Hildebrandt, Director, Market Monitoring  
**Date:** October 25, 2017  
**Re:** Department of Market Monitoring Report

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*This memorandum does not require Board action.*

## EXECUTIVE SUMMARY

This memo provides comments by the Department of Market Monitoring (DMM) on two Management proposals being presented to the Board for approval.

- **Capacity Procurement Mechanism Risk of Retirement Process Enhancements.** DMM supports Management's proposal to provide risk of retirement capacity procurement mechanism (CPM) designations earlier in the year. This change is an improvement in the current process which occurs too late in the year to be of practical use. Elements of the proposal reduce incentives for resources to seek CPM payments by feigning retirement. Concerns about CPM designations occurring before the resource adequacy process highlight the need to change the resource adequacy process timeline so that resource adequacy contracting is completed further in advance. The proposal is not designed to resolve incentives for resources to circumvent the CPM and resource adequacy processes by seeking reliability must run (RMR) contracts. Broader reforms to the CPM, resource adequacy, and RMR processes are required to address that issue.
- **Resource Adequacy Availability Incentive Mechanism.** Management's proposal is an improvement which mitigates significant problems that exist with the current resource adequacy availability incentive mechanism (RAAIM). Although DMM believes the time allowed for review and discussion of the details of the new approach provided in the final proposal has been limited, the ISO has indicated it must proceed with a proposal now in order to get a new RAAIM approach in effect before summer 2018. Given the importance of ensuring that capacity procured under the resource adequacy program is actually available to meet the ISO's operational needs, DMM recommends the ISO closely monitor the impact and effectiveness of the new RAAIM approach and be prepared to modify or enhance the methodology as needed.

## **Risk of Retirement Capacity Procurement Mechanism**

Management's proposal allows resource owners to be notified earlier in the year whether they will receive a risk of retirement capacity procurement mechanism (CPM) designation. Providing CPM designations earlier will make the risk of retirement CPM a more viable option for resources considering retirement. This change is an improvement to the current risk of retirement CPM process which occurs too late in the year to be of practical use for generators or the CAISO.

Another feature is the proposal to allow a resource to not retire if it later receives a resource adequacy contract through a bi-lateral agreement with a load serving entity. This flexibility allows resources that were uneconomic to stay in service when conditions change, mitigating the potential for an inefficient retirement.

Several aspects of the proposal reduce the likelihood that a resource will feign retirement in order to receive risk of retirement CPM designation. Management proposes to compensate a resource who receives a risk of retirement CPM at the resource's cost-of-service. The cost-of-service compensation reduces the potential for resources to seek extra rents from risk of retirement CPM designations compared to compensation at the regular CPM soft offer cap – which DMM expects should exceed the cost of service for many resources. The resource owner must also attest in writing that they intend to retire the unit. This increases the difficulty of potential gaming aimed at obtaining CPM payments in the proposed risk of retirement process.

The proposal creates an April application window before the annual resource adequacy process is complete in the fall of each year. Concerns about the risk of retirement CPM designations occurring before the resource adequacy process highlight the need to change the resource adequacy process timeline so that resource adequacy contracting is completed further in advance.

The proposal is not designed to resolve incentives for resources to circumvent the CPM and resource adequacy processes by seeking reliability must run (RMR) contracts. A resource can currently receive an RMR contract if it applies for retirement at any time during the year. Broader reforms to the CPM, resource adequacy, and RMR processes are required to address this issue.

## **Resource Adequacy Availability Incentive Mechanism**

Management's proposed changes to the RAIM calculations mitigates problems with the prior approach that created the need for the RAIM modification initiative. DMM views Management's proposal as an improvement over the current RAIM approach.

Details of the proposal were only defined in the form of equations in the Draft Final Proposal issued on September 21. Given the unanticipated problems with the prior formation and the complexity of the proposed formulas, the time allowed for review and

discussion of the final proposal by DMM and other stakeholders has been somewhat limited. However, the ISO has indicated it must proceed with a proposal now in order to get a new RAIM approach in effect before summer 2018.

Given the importance of ensuring that capacity procured under the resource adequacy program is actually available to meet the ISO's operational needs, DMM recommends the ISO closely monitor the impact and effectiveness of the new RAIM approach as it is implemented, and be prepared to modify or enhance the methodology as needed.