BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Consider Refinements to and Further Development of the Commission's Resource Adequacy Requirements Program.	Rulemaking R.05-12-013 (December 15, 2005)

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR ON REVISED PROPOSED DECISION

Pursuant Rule 14.3 of the Rules of Practice and Procedure of the California Public Utilities Commission, and the Assigned Administrative Law Judge's March 30, 2010 Ruling Providing For Comments and Replies Regarding the Revised Proposed Decision, the California Independent System Operator Corporation submits the following comments on the Revised Proposed Decision issued on March 9, 2010 in this proceeding.

I. INTRODUCTION

The ISO has consistently recommended in its comments that the overarching goal of the proceeding should be to develop a long-term Resource Adequacy ("RA") program that will facilitate open and efficient competition to produce the optimal, cost-effective mix of infrastructure investments sufficient to meet end-use demand at stable and reasonable prices and reliably provide for the operating requirements of the ISO balancing authority area.[1] The ISO believes that the long-term RA framework should (1) permit meaningful competition among generation (including new entry), demand response (including energy efficiency) and transmission projects to solve reliability

[1] ISO Comments February 29, 2008, pp. 2-7; ISO Reply Comments March 14, 2008, pp. 1-8; ISO Comments October 1, 2008, p. 4; ISO Comments December 2, 2009.

concerns, and (2) enable these options to be compared using transparent market-based mechanisms so that investors will come forward with high-quality offers, and the most cost-effective alternatives can be selected. Most importantly, the ISO believes that a transparent, competitive, market-based framework for long-term RA can be structured in a manner that is fully compatible with the Commission's regulation of procurement by its jurisdictional load-serving entities and which supports the state's environmental policy goals.[2]

The ISO submits that the Revised Proposed Decision issued on March 9, 2010 does not provide a framework for developing major and much needed enhancements to the current RA program. As discussed below, the ISO disagrees with the modifications in the Revised Proposed Decision that reject adoption of a multi-year forward commitment of RA capacity resources. Multi-year forward RA procurement is necessary to support long-term RA by fostering investment in new generation and competition between new investment and existing resources to provide RA capacity. The ISO also disagrees with the Revised Proposed Decision's recommendation to maintain the current bilateral contracting approach for procuring RA capacity. That approach does not represent the best choice among the options to improve the RA program for the long-term and facilitate development of new capacity consistent with Public Utilities Code Section 380.

Further, the ISO acknowledges that much time has passed since the Commission initiated this matter and set in motion the multiple rounds of workshops, proposals, and comments through which the parties and staff have discussed and presented their positions on the issues raised in this proceeding. During that time, the

[2] ISO Comments October 1, 2008, pp. 4-5.

other ISOs and RTOs in the United States have provided a wealth of new experience on the design and performance of centralized, forward capacity markets that the ISO submits must be carefully examined in considering what kind of market structure to adopt in California. The ISO, therefore, urges the Commission not to adopt one of the proposals currently on the record in this proceeding, but rather to adopt in principle a multi-year forward RA procurement structure supported by a multi-year forward collaborative assessment of needs as described in the Revised Proposed Decision, and a central capacity market structure that accommodates bilateral self-supply by load-serving entities.

II. MULTI-YEAR FORWARD COMMITMENT

The Proposed Decision, issued November 3, 2009, recommended adoption of a multi-year forward capacity procurement obligation that would be applicable to all jurisdictional load-serving entities and would include compliance demonstrations three, four, and five years in advance of the RA compliance years. Under the Proposed Decision, each load-serving entity would be required to show in its compliance demonstrations that it has procured at least 80 percent of its load-based capacity assessment five years out, and achieved 100 percent procurement by three years in advance of the compliance year.

As modified, the Revised Proposed Decision rejects the multi-year forward approach and maintains the existing one-year ahead RA process. The ISO submits that the Revised Proposed Decision's failure to recommend adoption of a multi-year forward capacity procurement obligation is unreasonable, unsupported by the record, and inconsistent with Public Utilities Code Section 380.

It is unreasonable for the Revised Proposed Decision to retain the current annual RA structure and ignore the significant improvement to the RA program that will result from adoption of a multi-year forward procurement obligation. The ISO has consistently stressed in its comments that the single most important improvement to the RA program that must result from this proceeding is the establishment of a multi-year forward procurement requirement and demonstration of committed RA capacity to serve consumers within the ISO balancing authority area.[3] A multi-year forward structure will allow transparent, economic competition between existing resources and new market-based investment to provide specified quantities of RA capacity at the system level and for each local capacity area.[4] The multi-year forward structure will also accommodate economic decisions to repower or retire existing generation and to invest in new demand response capability, and can be linked explicitly to decisions whether to upgrade transmission into constrained areas of the grid or rely on non-transmission alternatives. These benefits of multi-year forward RA commitment will not be realized if the Commission approves the Revised Proposed Decision and retains the current annual RA structure.

The need for a multi-year forward process for estimating requirements and procuring RA capacity has broad support in the record. The initial comments on the Proposed Decision express almost unanimous support, across a wide diversity of interests, including the ISO, for adopting the multi-year forward RA capacity procurement obligation, in conjunction with a central capacity market.[5]

---

[3] ISO Comments October 1, 2008, p.3.

[4] ISO Comments October 8, 2009, pp. 3-6.

[5] Comments submitted on December 2, 2009 by (i) the California Forward Capacity Market Advocates (NextEra Energy Resources, LLC, NRG Energy, Inc., RRI Energy, Inc., San Diego Gas &

Not only is the Revised Proposed Decision contrary to this broad-based record of support, its failure to adopt the multi-year forward commitment is inconsistent with Public Utilities Code Section 380. That statute requires the CPUC, in consultation with the ISO, to establish RA requirements for all load-serving entities that achieve all of the following objectives: 1) facilitate development of new generating capacity and retention of existing generating capacity that is economic and needed; 2) equitably allocate the cost of generating capacity and prevent shifting of costs between customer classes; and 3) minimize enforcement requirements and costs. The statute further requires the CPUC to determine and authorize the most efficient and equitable means for achieving all of the following: 1) meeting the objectives of the statute; 2) ensuring that investment is made in new generating capacity; 3) ensuring that existing, economic generating capacity is retained; and 4) ensuring that the cost of generating capacity is equitably allocated. With respect to these statutory goals, the ISO maintains that a multi-year forward RA framework would, unlike the current one-year ahead RA program, be far more successful in facilitating efficient investment in new generating capacity and economic decisions to retire or repower older capacity.

Today's one-year ahead RA process does not provide sufficient lead time, either for investment decisions and commitments by investors or for economical comparison of alternative infrastructure investments in a manner that yields the most cost-effective

---

Electric Company, and Southern California Edison Company), Alliance for Retail Energy Markets (Sempra Energy Solutions, Constellation Energy Commodities, Direct Energy LLC and RRI Energy, Inc.), Direct Access Customer Coalition (commercial, industrial and governmental end user customers participating in direct access), Safeway, Inc., Sempra Generation, Dynegy (Dynegy Morro Bay, LLC, Dynegy Moss Landing, LLC, and Dynegy Oakland, LLC), AES Southland, LLC, and the Regents of the University of California; (ii) Southern California Edison Company; (iii) Independent Energy Producers Association; (iv) Alliance for Retail Energy Markets; (v) Direct Access Customer Coalition; (vi) Calpine Corporation; (vii) Dynegy; and (viii) the ISO.

.

outcomes for consumers. Requiring multi-year forward commitment of RA capacity will change that. It will provide greater certainty and stronger financial incentives for owners of existing generation and potential investors in new facilities to make economic decisions about maintaining, upgrading, or building new facilities depending on the prices and quantities at which future RA capacity is transacted. This should directly facilitate development of new generating capacity and retention of existing generating capacity that is economic as required by Public Utilities Code Section 380. The ISO, therefore, urges the Commission to adopt in principle a multi-year forward RA procurement structure, supported by a multi-year forward collaborative assessment of needs.

III. BILATERAL TRADING APPROACH

Both the Proposed Decision and Revised Proposed Decision recommend retaining the current bilateral trading approach, under which load-serving entities will continue to procure RA capacity through bilateral contracts, with annual showings in which they will demonstrate their procurement of capacity to meet their forward requirements, either on a multi-year forward basis as in the Proposed Decision or just prior to the start of the compliance year as in the Revised Proposed Decision. In initial comments on the Proposed Decision, the ISO and other parties to this proceeding recognized nearly unanimously that the central capacity market is superior to the bilateral trading approach for numerous reasons, including transparency of capacity prices, economic efficiency, equitable allocation of RA capacity costs, and the ability to better accommodate direct access programs, all without adversely affecting the CPUC's ability to direct and oversee the capacity procurement of its jurisdictional load serving

entities and thereby to further the achievement of state environmental policy goals.

The ISO disagrees with the recommendation in the Revised Proposed Decision to retain the existing bilateral trading structure and submits that it is not supported by the record or consistent with Public Utilities Code 380. The ISO continues to believe, as stated in prior comments in this proceeding, that a central capacity market would complement and enhance the effectiveness of the multi-year forward RA program better than a purely bilateral approach.[6] Two essential strengths of a central capacity market that are not characteristics of the bilateral approach are the transparent capacity prices for capacity at the system level and in constrained local areas, and the accuracy with which the costs of capacity can be allocated based on each load-serving entity's actual load during each compliance month.

The ISO also disagrees with the Revised Proposed Decision's conclusion that the bilateral approach will necessarily be superior to the central market approach for procuring specific RA resource types needed to achieve California's environmental policy goals.[7] The ISO believes just the opposite, that a central market can be designed to procure and – something the bilateral approach cannot do – clearly price specific resource attributes, so that the needed resource types are procured efficiently, competitively and at the quantities needed. A useful analogy is the ISO's current spot market structure. Through the application of different types of constraints in an optimization algorithm, the market simultaneously clears energy supply and demand, procures multiple types of reserve capacity, and manages congestion on the grid, and as an outcome of the process generates transparent prices for each of these products

[6] ISO Comments October 8, 2008, pp. 1-8.
[7] Revised Proposed Decision, p. 63.

and services.

A capacity procurement approach that generates transparent capacity prices through a market clearing mechanism will lead to the most efficient procurement of RA capacity because it provides a level and open playing field for competition among existing generation, new generation investment, repowering or retirement decisions, and demand response investment. With regard to cost allocation, a central capacity market design allows for settlement of charges to load-serving entities and payments to suppliers at the end of each compliance month. This approach ensures that each load-serving entity is charged for its RA capacity requirement based on its actual load each month rather than based on a forecast. Moreover, this ex-post compliance approach under a central capacity market would better achieve the Section 380 requirement to minimize enforcement requirements and costs.

As another benefit, a central capacity market would provide an explicit platform for evaluating whether investment in new supply and demand response resources could substitute for a transmission upgrade into a constrained local load area. While it is possible today to compare the costs and benefits of non-transmission alternatives versus transmission upgrades, it is not necessarily practical to do so absent some mechanism for committing suppliers of the non-transmission alternatives to deliver the capacity by the time it will be needed. The central capacity market would provide the mechanism both for making the economic decision between transmission and non-wires alternatives and for committing the suppliers to deliver those non-wires resources that clear the market.

The ISO supports the recommendation in the Revised Proposed Decision to

develop a collaborative forward assessment of capacity needs with a multi-year forward horizon.[8] Indeed, the ISO has pointed out in its various comments in this proceeding that such an assessment is a necessary foundation for multi-year forward RA procurement requirements. Absent such requirements and the additional benefits of a central capacity market, however, a forward assessment of RA capacity needs may be informative, but it would provide no transparency into capacity prices at the system level or in constrained local areas.

Moreover, if as the Revised Proposed Decision seems to suggest, the multi-year forward assessment would be designed to identify and quantify future needs for the "specialized resources that meet California's environmental objectives,"[9] it is not clear how the mere identification of the needs will stimulate investment in the needed resources. The Revised Proposed Decision rejects a central capacity market structure that would facilitate this investment through open competition and price transparency. It does so based on an assertion that a central capacity market will promote investment in "generic RA capacity without significant regard to the locational, environmental, and operational aspects of the resource"[10] and worse, result "in ratepayer-supported capacity payments to new conventional coal plant development."[11] In rejecting the market approach, the Revised Proposed Decision finds, without explanation, that the current RA framework, supplemented by the collaborative forward assessment, will deliver the needed specialized resources efficiently. The ISO is concerned that the Revised Proposed Decision is shortsighted on this issue. We believe that the needs

---

8 Revised Proposed Decision, p. 72 and 73-4.
9 Id. at 82.
10 Id.
11 Id. at 63.

assessment by itself, unaccompanied by forward procurement mechanisms that generate transparent prices, would not contribute to either the efficiency of bilateral procurement or the accuracy with which the costs of capacity can be differentiated by multiple characteristics and allocated to each load-serving entity equitably and without excessive administrative complexity.

For the reasons just discussed, the central capacity market is superior to the bilateral trading approach for purposes of Public Utilities Code Section 380. That statute requires the CPUC to adopt the most efficient and equitable means for meeting the objectives of the statute, ensuring that investment is made in new generating capacity, ensuring retention of existing generating capacity that is economic; and ensuring that the cost of generating capacity is allocated equitably. The central capacity market represents the most efficient and equitable means to fulfill the requirements of the statute because its market structure will provide greater transparency into RA prices and appropriate price signals than bilateral contracts whose prices and terms are not public. For this reason, a central capacity market will induce greater competition in the supply of RA capacity than a purely bilateral contracting approach does. In addition, the cost allocation approach of a central capacity market, which allocates responsibility for RA capacity costs to load-serving entities after the fact based on their actual load in each compliance month, avoids cost-shifting and is the most accurate approach. Accordingly, the ISO urges the Commission to reject the recommendation of the Revised Proposed Decision as insufficiently satisfying the requirements of Public Utilities Code Section 380 and instead approve the development of a central capacity market within the context of a multi-year forward RA procurement structure.

The ISO believes that adoption of the central capacity market would not give rise to the significant concerns regarding jurisdiction that the Revised Proposed Decision postulates. The Revised Proposed Decision ignores FERC precedent that provides a clear statement of deference to state and local regulatory authorities to set RA requirements. In *California Independent System Operator,* 116 FERC ¶ 61,274 at p. 62,274 (2006), FERC stated that:

> 1117. The foregoing notwithstanding, we recognize the states' historical role in ensuring resource adequacy. The fact that we must, to fulfill our statutory responsibilities, be assured of a workable approach to resource adequacy does not mean that we should ignore the states' traditional role in this area. Rather, we can fulfill our jurisdictional responsibilities while also respecting the states' traditional role in this area. As a general matter, it is our responsibility to ensure that a workable resource adequacy requirement exists in a market such as that operated by the CAISO. This does not mean that we must determine all the elements of such a program in the first instance. Rather, we can, in appropriate circumstances, defer to state and Local Regulatory Authorities to set those requirements. Our primary responsibility is to ensure that a workable program exists and is adhered to by all LSEs.

The Revised Proposed Decision also overlooks the fact that under the central capacity models discussed in this proceeding, the load-serving entities' owned generation and bilaterally procured RA capacity, as overseen by the CPUC, would be self-supplied into the capacity market and would constitute the majority of RA capacity cleared through the central capacity market. Thus, a central capacity market would not undermine either the role of CPUC jurisdiction over bilateral capacity procurement or the role of compliance showings by its jurisdictional load-serving entities. The Commission will be able, among other things, to determine how much capacity its regulated load-serving entities are required to procure bilaterally and self-supply into the centralized capacity market, thereby limiting the price risk exposure faced by those

entities.

In addition, the ISO does not believe that a central capacity market would adversely affect the CPUC's ability to achieve state environmental goals. Through continued oversight of the load-serving entities' bilateral procurement of RA capacity, the CPUC would retain its authority to direct their procurement of environmentally preferable resource types. The ISO notes, moreover, that it is also fully committed to supporting the state's environmental policy goals and would explore ways to design a central capacity market to incorporate mechanisms, such as constraints in the market optimization, that would both procure and transparently price the specific resource attributes needed to achieve these goals.

For these reasons, the ISO urges the Commission to reject the Revised Proposed Decision's recommendation to rely solely on bilateral trading for forward RA procurement and instead adopt a central capacity market structure that accommodates bilateral self-supply by load-serving entities, which will better meet the needs of the RA program and fulfill the requirements of Public Utilities Code Section 380.

Finally, the ISO notes that it will begin a stakeholder process in 2010 to develop a revised backstop procurement design that will complement the CPUC's long-term RA framework to ensure reliable grid operation.[12] As the ISO indicated in its prior comments submitted in this proceeding, temporary backstop procurement mechanisms such as the previous Reliability Capacity Services Tariff and the existing Interim Capacity Procurement Mechanism were not intended and cannot be expected to function as durable backstop mechanisms. The Revised Proposed Decision

[12] The ISO is required by FERC to design and implement a replacement for the current Interim Capacity Procurement Mechanism by April 1, 2011, and therefore must initiate this effort in 2010.

appropriately recognizes that the absence of a durable backstop mechanism is a shortcoming of the current RA program that jeopardizes reliability and cost-effectiveness objectives.[13]

The need for a backstop procurement mechanism exists irrespective of whether the CPUC adopts a central capacity market or retains the current bilateral procurement approach in its final long-term RA decision. A central capacity market structure would, however, naturally incorporate the needed backstop mechanism through a sequence of reconfiguration auctions to make transparent adjustments to the amount of committed capacity as the compliance or delivery year gets closer, as has been proposed by the CFCMA and is part of the capacity market designs of other regional transmission organizations and independent system operators. In contrast, absent a central capacity market in California, the ISO's backstop procurement mechanism will be the only mechanism that provides a transparent capacity price signal to the market. Moreover, with a bilateral procurement structure where compliance is determined through multi-year forward showings by the load-serving entities, there will be an inefficient tradeoff by load-serving entities between the penalties assessed for any shortfall in their forward capacity procurement versus their allocated shares of the cost of backstop procurement. The central capacity market structure with ex-post allocation of costs avoids this complication of the load-serving entities' forward capacity procurement incentives.

[13] Revised Proposed Decision, p. 42.

IV. CONCLUSION

For the foregoing reasons, the CAISO respectfully requests that the Commission reject the Revised Proposed Decision, and instead adopt the CAISO's positions and recommendations in this matter and establish a long-term RA framework consistent with the discussion in these comments.

Respectfully submitted,

/s/ Beth Ann Burns

Anthony Ivancovich
Assistant General Counsel - Regulatory
Beth Ann Burns
Senior Counsel
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
151 Blue Ravine Road
Folsom California 95630
Tel. (916) 351-4400
Fax. (916) 608-7296
Email: bburns@caiso.com

April 16, 2010

CERTIFICATE OF SERVICE

I hereby certify that on April 16, 2010 I served, by electronic and United States mail, a copy of the foregoing COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR ON REVISED PROPOSED DECISION to each party in Docket No. R.05-12-013.

Executed on April 16, 2010
at Folsom, California

/s/ Anna Pascuzzo

Anna Pascuzzo
apascuzzo@caiso.com
An Employee of the California
Independent System Operator