

Comments of the Staff of the California Public Utilities Commission

On the CAISO Reliability Services Initiative Stakeholder Workshop—February 24th 2014

Submitted by	Company	Date Submitted
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CPUC Staff Comments on the Reliability Services Initiative Scope and the Residual Procurement Mechanism Proposals

The Staff of the California Public Utilities Commission (CPUC) appreciates the opportunity to comment on the proposals made at the California ISO's (CAISO) workshop on residual procurement mechanisms on February 24th, 2014. The CPUC staff is concerned that "residual procurement mechanisms" under development by CAISO, and specifically the proposals outlined for a possible "residual capacity" market with a voluntary component, goes beyond the agreed upon scope of the Joint Reliability Plan (JRP). Under the initiatives laid out in the JRP, and adopted by both the CPUC and the CAISO Board of Governor's in 2013, is a market-based mechanism to replace the Capacity Procurement Mechanism for backstop (CPM). The role of the CPM replacement is to allow the CAISO to "cure deficiencies in the resource adequacy program," and while the JRP states that the CAISO may consider a voluntary mechanism to allow LSE's to "buy forward capacity in excess of any forward capacity requirements" this does not appear to be the approach embodied in the CAISO's current proposal.

Based on CAISO staff presentations at the recent workshop, the CPUC staff understands that CAISO's proposal is to create a voluntary market for a portion of the LSE's year ahead and month-ahead RA requirements for system, local and flexible capacity that would run *after* RA compliance obligations are due. The CPUC staff notes that such a voluntary market mechanism, as described by CAISO at the recent workshop, may be inconsistent with the existing RA program rules and penalties as currently administered by the CPUC, and thus should be expected to have little liquidity. While there could potentially be some benefits in having a voluntary market for curing deficiencies prior to the backstop market, it's not clear if they would outweigh the potential risks, especially for certain types of procurement. Therefore, the CPUC staff urges CAISO to exercise caution in developing proposals for replacing the CPM that would expand the role of the CPM beyond backstop procurement, particularly in the month-ahead timeframe.

The CPUC staff therefore encourages the CAISO to re-focus the Reliability Services Initiative on developing a replacement for the CPM that is both (1) designed to be used infrequently and, (2) does

not rely on an assumption that the CPUC will change the monthly RA rules to eliminate penalties, as might be necessary if CPUC-jurisdictional LSEs were to submit month-ahead Resource Adequacy showings with deficiencies to be cured in the “voluntary” market. The CPUC staff also cautions the CAISO not to assume that the Commission would authorize LSEs to conduct a minimum level of procurement through a “residual” market. Commission decisions on such policy issues will be taken up in Track 3 of the JRP (R.14-02-001).

The CPUC staff are concerned that the CAISO may be envisioning a larger procurement role for the “residual” year-ahead and monthly market than the CPUC would likely agree to endorse. Accordingly, the CPUC staff recommend that the CAISO focus on developing the CPM replacement first, and then incorporate a potential “voluntary” market in a later phase, which could be useful for multi-year RA procurement beyond mandatory procurement minimums.

1. CAISO proposals for voluntary market mechanisms should maintain consistency with the JRP as adopted

The replacement mechanism for the CPM administrative price under CAISO’s tariff should not create a fundamental deviation from the intended purpose of the CPM. In other words, LSE’s should not have an incentive to under-procure and enter month-ahead RA showings with a deficiency or shortage in order to participate in a residual market. As the CPUC and CAISO agreed in the JRP, “[a]ny CPM replacement mechanism should also not be designed to be or become the primary forward capacity procurement mechanism for LSEs.”

The concept of a “voluntary” market articulated in the Joint Reliability Plan is different from what the CAISO is now proposing for “voluntary” and “mandatory” residual procurement. The CPUC staff are still of the opinion that a voluntary market that would occur pre-RA compliance periods is more consistent with current state policy objectives. The JRP discusses a “voluntary” market where LSEs could procure additional RA *beyond the minimum requirements* for the (potential) 2 and 3-year ahead time frames. For example, if the 3-year forward Local RA requirement was 70 percent of the expected requirement in the year-of-delivery, then an LSE who submitted a compliance showing/supply plan demonstrating resources to meet 70% of its need could additionally submit voluntary bids to procure above the 70% compliance showing in the “voluntary” auction, subject to authorization by its LRA.

Therefore, as our organizations agreed to under the JRP, “voluntary” procurement *would only occur above and beyond the forward RA compliance requirement amount*. The mandatory auction would clear the RA “requirement” amount if resources showed up short for the 1-year ahead compliance showings.

The concept of the voluntary market envisioned in the JRP makes sense in the context of forward-procurement obligations in the pre-compliance time-frame (it could allow LSEs to procure additional capacity *above* mandates, *ie*, for year ahead flexible or system, procuring >90% through a voluntary market). CPUC Staff can also envision a role for a voluntary market for a system year-ahead showing, where compliance is only 90%, to allow participants to reach 100% or above. But CPUC staff

has a difficult time envisioning a role for a voluntary, post-compliance market mechanism for local capacity or monthly system capacity, where compliance mandates 100% procurement.

2. A backstop mechanism design that conflicts with RA rules would be problematic

The Joint Reliability Plan stated: “the design of a market-based backstop procurement mechanism must fully accommodate resource procurement undertaken pursuant to CPUC decisions. Any CPM replacement mechanism should not inappropriately distort the prices or volume of bilaterally-negotiated capacity contracts.” The CPUC Staff is therefore concerned that the CAISO’s current proposal may not accommodate current CPUC jurisdictional resource procurement and might distort both the price and volume of bilateral RA contracting.

CAISO has not yet clarified the relationship between the “voluntary” market and the CPUC’s regulatory requirements for RA, and this will require further discussion. The concept of allowing LSEs to cure deficiencies in their annual or month-ahead RA showing is confusing as it appears to be inconsistent with the CPUC’s rules for assessing penalties on LSEs with deficiencies. An LSE could not “voluntarily” participate in a market during the cure period unless they entered the RA compliance period deficient. But, doing so would require an LSE to violate the CPUC’s RA requirements and could expose them to penalties.

Accordingly, the CAISO proposal appears to be problematic from numerous perspectives, because it seems to be premised on an assumption that the CPUC will waive or eliminate penalties for LSEs that enter a monthly or annual RA compliance showing deficient, or that the penalties will be so low that LSE’s will not be dis-incentivized to participate in the voluntary market. The CPUC is not currently proposing to eliminate or waive the existing penalty structure for the year-ahead or monthly RA program. (The CPUC may consider whether to institute penalties for LSE’s that are “short” in compliance showings for multi-year forward Resource Adequacy requirements, if they are adopted at the CPUC, but this remains subject to debate and decision).

3. A voluntary residual market-based procurement mechanism may not achieve CAISO goals of “optimized procurement”

The CPUC staff would like to see more analysis on the potential benefits of a broader “residual” procurement scheme. CAISO should not assume that a “voluntary” or backstop “residual” market mechanism is the singular or maximal way to achieve efficient resource procurement. CPUC staff urges CAISO to consider whether there is any empirical evidence to demonstrate that the current procurement system is actually an inadequate or inefficient way (relative to the costs/benefits of other options) to achieve procurement needed for resource adequacy programs.

Further, the CAISO staff cites the need for transparency as a motivation for this initiative. The CPUC staff encourages the CAISO to consider other policy tools that would allow our organizations, working together, to achieve the same objective. The JRP did not presume that a CAISO-run market is the only method to achieve the principles it articulates.

Indeed, there seem to be a few potential pitfalls, or at least drawbacks, to the assumption that the replacement for the CPM is the best or only way to improve procurement. First, the CPUC staff observes that if there is not a high level of liquidity in a backstop market, then the CAISO will likely need to continue to have an administratively set backstop price. The CAISO should include proposed details for such a mechanism in future proposals. Such a backstop price could be an extension of the exiting CPM, or it could be tied to the reported RA prices from the CPUC (such as a multiple of a rolling average of historic reported RA prices). An alternative to running a market could take the form of a price that is tied to changing market conditions, based on specific indicators (such as those found in the annual RA reports).

Second, having such a “residual” procurement option could create adverse reliability impacts if LSEs’ were given a motivation to shift procurement from the pre-compliance to post-compliance period, and thus would enter a month-ahead showing “short.” This could happen if the CPUC changed its penalty structure in response to a CAISO proposal such as this “residual procurement mechanism.” Having more LSEs enter the compliance demonstration period short could jeopardize reliability and undermine the goals of the CPUC and CAISO reliability-based RA program. Thus, the CAISO should be very careful that the proposed monthly or annual “residual procurement” auction process does not unintentionally create incentives for LSEs to disregard their RA requirements in order to try their luck in the CAISO-run residual capacity market. This is essential for the market to operate in a manner that does not have negative unintended consequences. As such, the CPUC staff encourages the CAISO to focus on achieving simplicity in both the backstop design and a simple and easy to decipher interface with the CPUC’s existing rules.

4. CPUC staff requests more information regarding the effects of implementing the CAISO’s replacement rule

At the workshop, the CAISO staff discussed issues related to the CAISO implementation of the replacement rule and indicated that the “average replacement requirement deficiency in a representative outage season month was in excess of 2,000 MW per day.” The CPUC Staff was surprised by this number, and wonder if excessive shortages in the month-ahead RA showings may indicate that the CAISO’s replacement outage rule is causing problems and not yielding expected results.

When the CPUC administered the replacement rule, CPUC staff did not observe the magnitude of the replacement requirement deficiencies that the CAISO is reporting, and the CAISO also implied that this was a change from previous observations of deficiencies. The CPUC’s scheduled outage replacement rule used a “de-rate” mechanism that varied between summer and non-summer months. For summer months, if a resource was on scheduled outage for more than 25% of the month, then the resource could not count towards the RA requirement. For non-summer months, if a resource was on outage for $\geq 50\%$ of the month then the resource could not count for RA credit. Outages 1- 2 weeks in length would be de-rated using the following formula: $[1 - (\text{days of scheduled outage} / \text{days in month})] \cdot 25$ MW. The CAISO should provide data comparing replacement requirement deficiency amounts in pre-CAISO rule and post-CAISO rule implementation periods through straw proposals and/or public meetings held as part of the RSI stakeholder process.

The CPUC staff also encourages CAISO to analyze the causes of an increase in outage-related deficiencies, and consider whether simplifying the replacement rules could better enhance reliability. Indeed, if data suggests that the CAISO's replacement rule change is adding costs and complexity to the process for requiring and submitting replacement RA, CPUC staff does not necessarily support designing a new, complex market mechanism to compensate for this. Rather, the CAISO should consider if a simpler solution, with lower implementation and transaction costs could mitigate the impacts caused by the rule change. For example, a simple "bulletin board" type tool that allows LSEs to find appropriate resources (generators) for replacement in the month ahead or day ahead could be a simple alternative to a new market mechanism, if in fact replacement needs are multiplying previously identified issues.

Response to Questions Posed by CAISO at February 24th Workshop

- a. What analysis should ISO perform before designing a residual procurement mechanism?
1. As explained above, The CPUC staff would like to see more analysis on the potential benefits and costs of a broader "residual" procurement scheme.
 2. Per the discussion above: analysis of the CPM/ CPM Replacement: how many backstop events are there currently for system (monthly, annual), local (monthly annual) and unsystematic? What are the forecasts/predictions for these to change over time?
 - i. Analysis of the present reliability threat caused by scheduled outage replacement deficiencies: specifically, it would be helpful to see monthly deficiencies showing the length and magnitude of the deficiency, translated as a percentage of total system load.
 - ii. Exceptional dispatch analysis: it would be helpful to have a better understanding of the historical exceptional dispatch, and based on this, which categories of exceptional dispatch would/would not lend themselves to an auction for backstop?
 3. Under different scenarios of future flexibility needs, what does CAISO expect to see regarding the need for backstop, ie, what percentage increase in backstop, and in MWs, does CAISO think might be necessary (as a range)?
 4. It would be helpful to know what percent of necessary capacity CAISO expects to see procured through both 1) a voluntary and 2) a mandatory "residual procurement mechanism"? The CAISO proposal implies that these values might be significant.