Comments of the Staff of the California Public Utilities Commission on the CAISO's Reliability Services Initiative Straw Proposal (June 5, 2014)

Submitted by	Company	Date Submitted
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The Staff of the California Public Utilities Commission (CPUC Staff) appreciates this opportunity to comment on the Draft Straw Proposal for the Reliability Services Initiative following the June 12, 2014 stakeholder meeting.

1. **Please provide feedback on Part 1: Minimum eligibility criteria and must-offer rules.**
    a. Comments on proposal portion of section
        i. Eligibility criteria
        ii. Must-offer requirements

The CPUC Staff seeks clarification regarding the applicable Must Offer Obligations ("MOO") and eligibility criteria for demand response resources. In current rulemakings on demand response, the CPUC Staff has proposed to connect future procurement mechanisms and Resource Adequacy requirements for demand response with the CAISO's MOO. However, the RSI straw proposal is largely silent about demand response and therefore the CPUC Staff requests that the CAISO's next straw proposal clearly identify if and how the CAISO interprets the requirements in the existing or proposed tariff as they apply to demand response resources.

At two recent public stakeholder meetings, the CAISO described its proposed MOO requirements for use-limited resources and how they would specifically apply to demand response. These two meetings occurred on June 11, 2014 (workshop in CPUC Rulemaking (R13-09-011) and April 23, 2014 (stakeholder meeting at the CAISO on the RSI). At both the CAISO working group meeting and the CPUC workshop, CAISO staff described the MOO requirement for demand response as follows:

1) Demand response resources would be required to be available during the hours specified in the resources' use plan, as submitted to the CAISO.
2) The minimum monthly availability requirements for Proxy Demand Resources (PDR) will be consistent with CPUC minimum availability criteria.
3) Thus, given both of the above requirements, any availability incentives (e.g., the penalty payments or rewards assessed to resource adequacy resources) will be assessed based on this availability.

Upon review, the Reliability Services Straw Proposal released on June 5, 2014, appears consistent with this description. Given dynamic discussions on future policies for demand response currently underway, however, the CPUC Staff respectfully requests that the CAISO provide more detail in the next straw proposal on the applicability of MOO requirements for demand response resources in order to clarify expected bidding requirements for demand response and how availability incentives will be measured.

b. Comments on phase 2 consideration items

c. Other comments

2. **Part 2: Availability Incentive Mechanism.**

The CPUC Staff will provide comments on Part 2 at a later date.

3. **Part 3: Replacement and Substitution.**

The CPUC Staff will provide comments on Part 3 at a later date.

4. **Part 4: Capacity Procurement Mechanism.**

The CPUC Staff supports the CAISO's change in direction on developing a replacement for the CPM, and specifically the move away from a proposal to use an auction mechanism to determine the CPM price. The CPUC Staff generally finds the proposed option for a competitive solicitation process for backstop procurement to be reasonable and workable at this point in the stakeholder process. Further, it should be possible to develop the solicitation option relatively quickly so that parties to the CPUC's JRP Rulemaking (R.14-02-001) will have opportunity to review and comment on a near final proposal during 2014. This seems to be in line with the expectations and timeline of the CPUC's proceeding.

a. Comments on index price

The CPUC Staff understands why CAISO believes that developing an index price based on existing bilateral capacity contracts would be more challenging than using a competitive solicitation process, given that the contract prices would need to be normalized to account for the variety in contract types and conditions under which the LSEs enter into them. The CPUC Staff nevertheless expects that an indexed price could be useful as a way to derive an offer cap or price ceiling, if needed.

b. Comments on competitive solicitation process

As the CAISO further develops the proposed competitive solicitation process, the CPUC Staff encourages the CAISO to emphasize and flesh out the selection criteria and the weighting and ranking process it will use when selecting backstop capacity to procure. The designation criteria in §43.4 of the tariff provide a good starting point,[1] but the CAISO should further detail

[1] See RSI Straw Proposal at 61.

how it will evaluate the relationship between effectiveness and price and develop robust selection criteria and processes that appropriately weigh the two.

Regarding the proposed timelines (Sections 9.5.1 and 9.5.2) for the solicitation process, the CPUC Staff seeks further details on when offers will be "dismissed" and to specifically further clarify the process and timeline for when offers would be "locked in". Further details regarding the timeframe for when offers into the monthly solicitation would be "firm," would be helpful. Also, the timing around using existing offers for "significant events" is somewhat confusing in the proposal.

Finally, the CPUC Staff recommends that the CAISO describe the contingency measures it will take in the event that the CAISO determines a CPM designation is needed and seeks to undertake backstop procurement but there are no offers in the annual or monthly solicitation processes. The CAISO should describe what contingency process will be used and how it will determine the CPM price or other price (e.g. a price determined through the Reliability Must Run process) to designated capacity in the absence of CPM offers.

The CPUC Staff supports a requirement that a resource must have offered all qualifying capacity into all CPM solicitation processes in order to qualify for a risk-of-retirement designation (section 9.5.4). But the CAISO should also assess potential market power of the resource seeking to retire (at the level of system, flexible, or local areas) and, if needed, mitigate the resource's bid. Without market power assessment (and mitigation if needed), or at least some other form of price review, the CAISO has no basis to assume granting a resource its annual bid would yield a just and reasonable result.

As a hypothetical example, consider a resource that has local market power or otherwise knows that it is very likely to be needed for reliability purposes in the year following the current resource adequacy compliance year. The CAISO should assess whether a resource could submit an inflated/non-competitive bid into both the resource adequacy or CPM solicitation processes, knowing that if it failed to secure a resource adequacy contract CPM designation it would nevertheless receive a risk-of-retirement designation (and thus ultimately receive its inflated bid price). The CAISO must thoroughly vet the proposed competitive solicitation process to ensure it does not create unintended incentives for resources to economically withhold resources from the bilateral or backstop markets.

c. <u>Comments on other changes potentially needed to CPM</u>

d. <u>Comments on CPM price</u>

e. <u>Comments on supply-side market power mitigation measures</u>

Market power assessment and mitigation measures will be needed for the proposed competitive solicitation process and are a critical feature to be developed and included in the final proposal, and not simply for resources that may be at risk of retirement. The CAISO should propose options for market power mitigation measures for each solicitation process early on in the development of the solicitation process. Market power assessment (with price mitigation if warranted) is one of the most important aspects to consider for any CPM replacement. Various forms of market power would need to be evaluated.

The CPUC Staff strongly supports having the CAISO assess individual resources' market power and perform individual bid mitigation when needed (e.g., if a CPM designation is needed), rather than using a fixed or varying offer price cap that is administratively derived and applied to all resources. Further, an offer cap set at the net cost of new entry (net-CONE) based on a proxy price for a hypothetical new resource is especially inappropriate. It is settled policy in California that a backstop mechanism should not be used to incent the development of new generation. However, if the CAISO seeks to derive a price cap for offers/bids, it may be appropriate to use an index of (bilateral) resource adequacy contract prices provided by the CPUC and the CAISO should expressly consider this option.

f. <u>Comments on demand-side market power mitigation measures</u>

The CPUC Staff agrees that demand side market power issues are unlikely to arise in the competitive solicitation framework proposed for the replacement backstop Capacity Procurement Mechanism. Accordingly, the CPUC Staff does not support the development of price floors such as a minimum offer price rule or other generic price floor.

g. <u>Other comments</u>