STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

TO: **SCPM@caiso.com**

FROM: Donald Brooks (dbr@cpuc.ca.gov)
Kevin Dudney (kd1@cpuc.ca.gov)
Elizabeth Dorman (edd@cpuc.ca.gov)

RE: Comments of the CPUC on the CAISO's *Draft Final Proposal: Standard Capacity Product II*

DATE: March 3, 2010

Introduction

The CPUC staff appreciates the opportunity to comment on this draft proposal. The CPUC staff supports most of the provisions, and here submits suggested edits for several other provisions.

- CPUC staff supports the calculation of availability as specified in section 4.1.2.

- CPUC staff supports installation of replacement obligation in CAISO tariff.

- CPUC staff believes that the Draft Final Proposal erroneously causes a mandatory ICPM designation, as opposed to the CAISO's discretionary ability to designate replacement capacity discussed in the original draft proposal. CPUC staff prefers the RA replacement provisions described in the Straw Proposal.

- CPUC staff strongly disagrees with SCE's proposal due to practical, procedural, and economic grounds.

CPUC Staff Generally Supports the Proposal

The CPUC staff supports the Proposal's pro rata decrease of the availability factor applicable to wind and solar facilities, which is based on assumptions regarding the generation characteristics of those types of units. The CPUC staff, however, opposes this approach when it comes to other types of resources, such as cogeneration and biomass units, as they perform more similarly to conventional thermal generation.

Wind and solar generators are often grouped together in fields. When there is an equipment failure on one turbine or one panel, the other turbines or panels do not generate additional energy. To illustrate, when wind is blowing at a certain velocity, a turbine failure does not move that wind to other turbines to maintain the same level of total energy production for the field of turbines. A partial outage of a wind field (i.e., the malfunction of a subset of the turbines in the field) creates a decrease in the ability of that field to produce energy. Thus, the pro rata decrease of availability over the NQC of the facility is reasonable and realistic.

This approach is not reasonable for cogeneration or biomass resources because the binding constraint on these types of plants is often related to fuel rather than productive capability. For example, a cogeneration plant might have an NQC lower than PMax due to historical limitations on fuel availability. A slight equipment failure would not affect the historical availability or schedule of fuel delivery, and thus a slight decrease in equipment ability may not decrease the overall production of the plant below NQC. Therefore, a partial outage on a steam turbine does not necessarily mean that the remaining equipment cannot maintain the required level of energy production. Thus, the subtraction method is more reasonable for cogeneration, biomass, and geothermal facilities.

CPUC Staff Proposes Modifications to the Current Proposal

CPUC staff strongly supports the inclusion of a replacement obligation in the CAISO tariff in accord with the Straw Proposal posted on January 19, 2010. Without this replacement obligation, the CAISO may run the risk of being unable to properly manage scheduled outages and operate the grid. The CPUC RA Program currently includes a replacement obligation requiring LSEs to replace units that are on scheduled outage. Moving this obligation to the CAISO tariff frees LSEs of the obligation to monitor the performance of the suppliers with which they contract, and promotes the tradability of RA capacity, consistent with the goals of the CPUC and the SCP. The CPUC staff strongly supports the version of the proposal included in the January 19 Draft Straw Proposal and presented at the CPUC workshop on January 26.

The CPUC staff requests that the CAISO reconsider the changes made to the mechanics of the replacement obligation included the Draft Final Proposal. The CPUC staff believes that the Straw Proposal posted on January 19 created the proper balance between replacement obligation and actual CAISO operations, which the Draft Final Proposal disrupts. The January 19 Draft Straw Proposal allowed RA suppliers to submit replacement capacity as a means of potentially offset backstop costs. In the event that the supplier did not provide replacement, the CAISO would decide whether to procure additional capacity based on then-apparent system needs. The CAISO listed three possible outcomes in the event an RA supplier requested approval for a planned outage and did not provide replacement capacity: 1) the CAISO could deny the outage, 2) the CAISO approve the outage and charge the RA supplier ICPM costs for backstop, or 3) the CAISO could approve the outage and determine that no replacement was necessary under the circumstances.

The possibility of the CAISO determining that replacement is not needed was removed from the Draft Final Proposal. The CPUC staff strongly opposes the removal of this option. There may be instances where the CAISO has sufficient RA resources to meet load and would not need replacement capacity, or instances where in the course of operations the CAISO may not be able to usefully utilize replacement capacity provided by generators to reliably operate the grid. This third outcome also enables a tighter coordination between outage coordination and system operations. The CAISO is in the best position to approve or deny outages in the optimal combination so as to minimize reliability risks. Placing a generic and invariable requirement on RA suppliers risks the procurement of replacement capacity that is either not a good replacement given the circumstances, or is unnecessary because capacity provided within the Planning Reserve Margin is sufficient.

In addition to placing the mandatory replacement obligation on the RA suppliers, the Draft Final Proposal also provides that any time an RA supplier fails to supply replacement capacity, the CAISO will enter into an ICPM contract to replace that capacity. As discussed above, this provision is economically inefficient as it implies that in all cases where an RA supplier receives approval for a scheduled outage, there is the need for capacity to replace it. If the procurement of ICPM were mandatory in this case, there would be no opportunity for CAISO flexibility in the event resources were sufficient to meet system conditions. CPUC staff strongly believes that replacements will not be needed in all cases of an approved outage on an RA supplier. For example, the Local RA program requires procurement levels to be held constant throughout the year. Because load is lower in off peak months, the CAISO is currently able to manage outages on most Local RA units without requiring replacement for them. CAISO may find situations where the same efficiency and management can be brought to system RA procurement.

The CPUC staff believes a better solution, implied by the Straw Proposal, is that the CAISO may find reliability and economic benefits to the system by more tightly coordinating the RA program administration and the CAISO outage scheduling. Specifically, the CAISO could approve or deny outages with full knowledge of which units are confirmed for RA that month, and how much excess capacity is currently provided by the RA program. If, for example, there is an excess of capacity confirmed to provide RA, the CAISO can approve more outages than they would be able to otherwise. The CAISO would be engaging in unnecessary procurement at ratepayer expense if it were to require capacity replacement or execute ICPM contracts in instances of excess RA or low demand. The CPUC staff hopes to preserve the CAISO's ability to procure replacement capacity only when grid conditions indicate it is needed.

Lastly, the Draft Final Proposal may have the unintended consequence of drawing the LSE back into the monitoring of RA supplier performance in two relatively minor but preventable ways. First, as discussed during the stakeholder call on February 26, the Draft Final Proposal to disapprove the supply plans for RA suppliers that do not supply replacement capacity may have the unintended consequence of leading to the disapproval of the LSE RA filings that currently are matched to those supply plans. Thus, the CAISO should clarify that a supply plan from an RA supplier that is disapproved for reasons of not supplying replacement capacity would not indicate a mismatch for purposes of LSE RA compliance. Second, the CAISO should clarify that in the event that an RA supplier fails to provide replacement capacity in the same Local Area (in the case of an outage of a Local RA unit) that the CAISO may undertake ICPM procurement, but would not bill the LSE for the deficiency. The CAISO should in such a case bill the RA supplier, not the LSE, for the ICPM capacity procured as local RA replacement. Such changes may require modification to the ICPM tariff to allow a different billing mechanism than is currently provided.

CPUC response to SCE proposal:

The CPUC staff offers these comments on the SCE proposal discussed at the February 26th SCP II conference call. The CPUC staff strongly disagrees with SCE's proposal because it will interfere with the calculation of the PRM, as well as the calculation of setting the RA obligation each year. The CPUC staff also has economic policy concerns with SCE's proposal.

SCE's proposal requires assessment of the average level of planned outages in each month. This is not an easy endeavor, and requires some amount of planned outages to be deemed acceptable by the CAISO. The CPUC staff believes that there are only cosmetic differences between SCE's proposal and a proposal to increase the PRM for the amount of planned outages CAISO deems appropriate.

SCE's proposal also interferes with the determination of the LSEs' respective RA obligations. The current RA obligation is a specific monthly amount, which is the sum of the monthly specific peak load added to the static PRM. SCE's proposal creates a new component, increasing the LSE's RA obligation. This would be a substantial modification to the CPUC's RA program, which has not been discussed by the CPUC since prior to the original 2006 implementation of the California RA program. The CPUC staff believes a more appropriate way to make this proposal is to for SCE to propose an annual RA obligation in the CPUC's RA proceeding, as the FERC has determined that the state (or other relevant local regulatory authority) is the appropriate designer of a long-term procurement program.[1] The CPUC staff would be happy to entertain that proposal for analysis and party comment.

In terms of economic policy, SCE's proposal, while accomplishing the objective of separating LSEs from performance monitoring, does not observe the principles of cost causation and may not, for reasons highlighted above, produce economically efficient outcomes. First, the effect of a RA supplier's planned outage is to raise the LSEs' RA procurement obligations for LSEs. This means that costs associated with RA supplier activities are paid by LSEs, which did not cause those costs and cannot affect them except through contractual terms. Both because this is a gaming opportunity, and because LSEs are not responsible for outages of RA suppliers, the RA suppliers ought to be responsible for this cost, not LSEs.

Finally, SCE's proposal may not produce the economically efficient results, since this is a static amount of capacity procured by LSEs in excess of expected load and PRM. This means that, as with the proposed mandatory replacement for all outages discussed above, the CAISO gets replacement capacity even in situations where the planned outages individually may not threaten grid reliability. The CAISO would receive an overage of capacity in situations where the CAISO does not need replacement capacity. Thus, the SCE proposal would likely create excessive and non-beneficial costs for customers.

[1] FERC *Order Conditionally Accepting The California Independent System Operator's Electric Tariff Filing To Reflect Market Redesign And Technology Upgrade*, issued September 21, 2006 in Docket No. ER06-615 ("September 2006 Order") 116 FERC ¶ 61,274 at p. 1117.