

#### Stakeholder Comments

### **Reliability Services Issue Paper, Posted January 28, 2014**

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The Office of Ratepayer Advocates (ORA) provides the following stakeholder comments on the Reliability Services (RS) Issue Paper, posted January 28, 2014.

#### **I. Issues within scope of Reliability Services Issue Paper – Concerns**

1. Both the development process for, and the substantive features of, a CAISOadministered market mechanism for the procurement of backstop capacity should complement, but not potentially displace, the California Public Utilities Commission (CPUC) adopted Resource Adequacy (RA) rules, processes, and eventual revised RA procurement mechanism.

The Joint Reliability Plan (JRP) agreement between the CPUC and California Independent System Operator (CAISO) determined that "[p]articipation in a Reliability Services Auction [RSA] will be subject to all existing laws and regulations that govern existing procurement obligations on LSEs. For the CPUC jurisdictional utilities, participation would be subject to any limitations or authority provided through the CPUC-approved bundled procurement plans or otherwise applicable decisions that issue from the CPUC.<sup>11</sup> The CAISO's development of the market-based backstop mechanism should be consistent with existing CPUC RA rules so that the final product is effective, durable, and promotes certainty rather than confusion. Notably, the CPUC's process for revising those RA rules and regulations is well underway; while it is not premature for CAISO to begin designing a new backstop procurement mechanism to replace the backstop Capacity Procurement Mechanism (CPM) that will expire in 2016, care must be taken so that the development of such a mechanism does not undermine the CPUC-driven process for revising the RA program or the RA reforms developed in the CPUC's RA and JRP proceedings. Any modifications to the RA rules and regulations necessary to support a market mechanism for the procurement of backstop capacity should first be considered in the CPUC's RA proceeding and recently instituted JRP proceeding.<sup>2</sup> These modifications should be justified by data and analysis, and subject to vetting and validation from parties.

# 2. By design, a "backstop" mechanism should recognize the primacy of any multi-step forward RA procurement mechanism – per the forthcoming CPUC revised RA structure – and not serve as a parallel forward procurement path for needed resources.

It should not be presumed that a market-based backstop mechanism to replace the CPM must necessarily serve as a forward capacity procurement mechanism. The JRP agreement, approved by the CAISO board, states that "[a]ny CPM replacement mechanism should also not be designed to be or become the primary forward capacity procurement mechanism for LSE's."<sup>3</sup> The proposed market mechanism does not necessarily need to, and perhaps should not, recommend backstop capacity procurement at each temporal phase of the CPUC's RA procurement (i.e., multi-year, annual, and monthly), and the proposal should not result in a redundant or a competing forward procurement mechanism.

The CAISO process should allow for stakeholder comment on the various forms a CPM could take. While there may be disagreement on the extent to which the backstop procurement should be completed in forward time frames, it should not be predetermined at the outset of the

<sup>&</sup>lt;sup>1</sup> Joint Reliability Plan (JRP), p. 9, adopted November 14, 2013 available at http://docs.cpuc.ca.gov/SearchRes.aspx?docformat=ALL&DocID=81666376

<sup>&</sup>lt;sup>2</sup> Order Instituting Rulemaking (JRP OIR), R.14-02-001, issued February 13, 2014, available at http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M087/K779/87779434.PDF

<sup>&</sup>lt;sup>3</sup> JRP, p. 10.



CAISO process that the new backstop CPM should operate in the same forward timeframes that the revised CPUC RA mechanism will address. In fact, a successful RA program that may be extended farther forward should minimize the need for backstop procurement to cure near-term deficiencies. For example, a reasonable complementary backstop mechanism may primarily serve to secure intra-monthly capacity to meet system, local and flexibility needs, in a competitive manner, along with its current role in securing capacity in short time frames for exceptional dispatch, in response to exceptional events.

"Risk of retirement" considerations, which are forward in nature, may be best addressed solely through the CPUC's RA mechanisms to prevent "venue shopping" by owners of resources looking to secure contracts for multi-year periods, particularly for resources capable of providing flexibility. Developers of the market-based backstop mechanism should presume that the CPUC-driven RA / JRP process will effectively determine flexibility needs, and that the revised process will result in sufficient flexible resources under contract to support forward-year reliability concerns.

## **3.** The Flexible Resource Adequacy Criteria and Must-Offer Obligation (FRAC MOO) framework should be consistent with the CPUC's June 2013 RA decision.

The CAISO's Reliability Services Issue Paper notes that the FRAC MOO initiative will add an additional category to the CPM and allow the CAISO to backstop for flexibility requirements.<sup>4</sup> In its June 2013 RA decision, the CPUC defined the flexibility capacity need as the quantity or resources needed by the CAISO to manage grid reliability during the greatest three-hour continuous ramp in each month.<sup>5</sup> Resources are considered "flexible capacity" if they can sustain or increase output, or reduce ramping needs, during the hours of the ramping period of "flexible need."<sup>6</sup> According to this definition, a resource that provides six hours of energy should be able to count as flexible capacity.<sup>7</sup> ORA agrees with PG&E's observation that the four

<sup>&</sup>lt;sup>4</sup> Reliability Services Issue Paper, p. 4.

<sup>&</sup>lt;sup>5</sup> CPUC Decision (D).13-06-024, p. 2, available at http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M070/K423/70423172.PDF

<sup>&</sup>lt;sup>6</sup> Id.

<sup>&</sup>lt;sup>7</sup> ORA acknowledges that CAISO's FRAC MOO Draft Final Proposal, posted February 7, 2014, has consolidated the four flexible capacity categories it previously proposed into three categories. This change also allows resources that can provide the equivalent of six hours of energy at the full effective flexible capacity (EFC) to be included in all flexible capacity categories.

flexible capacity procurement categories proposed in CAISO's FRAC MOO Fifth Revised Straw Proposal are inconsistent with the flexibility requirement adopted in the June 2013 RA decision.<sup>8</sup> Furthermore, ORA agrees that minimum and maximum procurement targets and different must offer obligations (MOO) for each of the four flexible capacity procurement categories infringe upon the jurisdiction of the CPUC and other local regulatory authorities (LRAs) by developing prescriptive requirements for the counting of resources.<sup>9</sup> Any modifications to the CAISO and CPUC jointly-defined flexibility requirement should be considered in the CPUC's RA proceeding, justified by data and analysis, and allow for vetting and validation by stakeholders.

## 4. The Reliability Services Initiative correctly identifies market power concerns within the scope of issues for designing a market-based backstop mechanism.

ORA is concerned about the potential for the abuse of market power in transmissionconstrained local capacity areas and agrees that the design of a market-based backstop mechanism should incorporate market power mitigation measures. In addition to implementing new strategies for market power mitigation, some of the current market power mitigation measures should be retained.<sup>10</sup> Proposed market power mitigation measures should be studied by stakeholders, the CAISO's Market Surveillance Committee (MSC) and Department of Market Monitoring (DMM) to determine their effect on ratepayer costs. In the absence of effective market power mitigation strategies, generators with a large concentration of resources in a particular Local Capacity Area could withhold resources to extract more revenue, thereby raising costs to ratepayers. A fundamental question, which should be added to the scope of the Reliability Services Initiative, is whether market power mitigation measures have the potential to minimize or eliminate the benefits of any change in the backstop mechanism design. A proposed market-based backstop mechanism may require market power mitigation measures that, when

<sup>&</sup>lt;sup>8</sup> PG&E comments on Flexible Resource Adequacy Criteria and Must-Offer Obligation Fifth Revised Straw Proposal, p. 2.

<sup>&</sup>lt;sup>9</sup> PG&E comments on Flexible Resource Adequacy Criteria and Must-Offer Obligation Fifth Revised Straw Proposal, p. 2.

<sup>&</sup>lt;sup>10</sup> The Commission established the Resource Adequacy bilateral capacity market, which limited market power abuse by, among other things, maintaining the confidentiality of the utilities' compliance with RA requirements and the capacity prices secured in IOUs' RFOs and bilateral contracts. Therefore, market participants are not aware of how much residual capacity the IOUs need when negotiating with generators.



taken together, may not advance the JRP's "goal of improving and enhancing the existing reliability framework's procurement requirements and processes."<sup>11</sup>

#### **II.** Issues that should be added to the scope of Reliability Services initiative

### 1. The Reliability Services initiative should consider the impact on ratepayer costs of adopting a market-based backstop mechanism to replace the existing CPM.

Since 2009, the CAISO has spent \$32 million for short-term capacity backstop via the CPM; \$28 million of this total was due to the extended outage at the now closed San Onofre Nuclear Generating Station (SONGS), which was taken out of service unexpectedly in January 2012. The CPM was used only twice in 2013, at a total cost of approximately \$3 million dollars.<sup>12</sup> These amounts are an infinitesimal portion of the various payments customers have made for capacity over the past several years. One of the issues that should be added to the scope of the Reliability Service initiative is how a market-based backstop mechanism will impact ratepayer costs. The impact on ratepayer costs would be particularly significant if CAISO's proposal for a market-based backstop mechanism will add "insufficient flexible in annual or monthly resource plan"<sup>13</sup> and "insufficient multi-year forward capacity"<sup>14</sup> CPM backstop events. Given that the CPM expenses under the status quo have been relatively small, it is prudent to examine how these expenses are likely to change and how ratepayers should be protected from increasing costs under a market-based backstop mechanism. ORA supports consideration of ways to reduce ratepayer costs, including lowering transaction costs and eliminating the current month-long payment to resources that might only be required to provide backstop capacity for weekly timeframes.

<sup>&</sup>lt;sup>11</sup> JRP, p. 3.

<sup>&</sup>lt;sup>12</sup> See CAISO presentation, available at http://www.ferc.gov/EventCalendar/Files/20110428065914-CAISO%20CPM%20presentation%204-28-11.pdf; 2013 capacity procurement mechanism reports, available at

http://www.caiso.com/Documents/Capacity%20procurement%20mechanism/2013%20capacity%20procu rement%20mechanism%20reports; and Capacity procurement mechanism reports archive, available at http://www.caiso.com/Documents/Capacity%20procurement%20mechanism%20reports%20archive <sup>13</sup> Reliability Services Issue Paper, p. 13.

<sup>&</sup>lt;sup>14</sup> *Id*.



# 2. The economic and legal viability of a proposed market-based backstop mechanism should be within scope and explicitly addressed in CAISO's forthcoming market design Straw Proposal.

A CAISO stakeholder process established to design a market-based replacement backstop mechanism to cure deficiencies, which might also include the development of a voluntary forward capacity market, must address the economic and legal viability of whatever mechanism is proposed by the CAISO in its forthcoming Straw Proposal. Moreover, any mechanism designed and proposed by the CAISO should anticipate and incorporate specific proposals to mitigate potential economic and legal viability risks. The CPUC's recently issued JRP Order Instituting Rulemaking (OIR) includes relevant questions for consideration. For example, regarding economic viability, the JRP OIR states:<sup>15</sup>

- Would resources opt out of the bilateral capacity market in favor of the backstop procurement method, and if so, are there risks that the backstop market would be become a *de facto* primary procurement market?
- If the backstop market becomes a *de facto* primary procurement market, what are the risks to the state's preferred resources policies?

Regarding legal viability of maintaining a limited role for a proposed backstop procurement mechanism, the JRP OIR posed these questions:<sup>16</sup>

- Would [CPUC] support for the proposed backstop procurement mechanism create risks that FERC or the courts will overturn rules limiting the amount or type o[f] procurement that may be conducted using the proposed mechanism?
- How should a proposed tariff amendment for a market-based backstop procurement mechanism be structured in order to prevent material design modifications or rule changes in the future, either by FERC or in response to legal challenges initiated by third parties?

The JRP OIR emphasizes that the Commission "will not revisit our decision rejecting a centralized capacity market in this proceeding" but "will, however, consider alternative proposals…such as supporting a <u>limited</u> form of an organized capacity auction to fulfill CAISO

<sup>&</sup>lt;sup>15</sup> JRP OIR, p, 14.

<sup>&</sup>lt;sup>16</sup> *Id.*, p.15.

backstop procurement."<sup>17</sup> In an amicus brief recently filed in the United States Court of Appeals for the Third Circuit, the CPUC reiterated its concern regarding potential federal preemption of a "limited" backstop capacity auction, stating that the New Jersey U.S. District Court's decision, "if upheld on appeal, has the potential to negatively impact California's support for such a market."<sup>18</sup> These are critical questions and issues to be addressed in the CAISO's design of any proposed market mechanism, particularly in light of several decisions casting uncertainty over the preemptive impact of organized markets. Several of these decisions are currently pending rehearing and appeal before FERC and the federal courts.

For example, pending rehearing at FERC are decisions concerning the New England ISO (ISO-NE) and Midwest Independent Transmission System Operator, Inc. (MISO). FERC determinations in these cases will inform both the CAISO and the CPUC as to how FERC will seek to accommodate states' pursuit of legitimate policy objectives such as development of renewable resources while fulfilling its statutory obligation to ensure just and reasonable wholesale prices and grid reliability. The ISO-NE case is a good example of how FERC's concerns over efficient wholesale prices may trump states' policy concerns over the types of resources to be procured.<sup>19</sup> ISO-NE administers a forward market for capacity (FCM), in which resources compete in an annual Forward Capacity Auction (FCA) to provide capacity on a threeyear forward basis. Due to its concerns over mitigating buyer market power, FERC approved a request for a buyer-side floor mitigation mechanism (Minimum Offer Price Rule or MOPR) without granting an exemption for state sponsored renewable resources. State entities argued that if FERC did not grant an exemption from a MOPR for renewable resources, then state policy goals related to renewable resource development would be undermined.<sup>20</sup> In denying the state entities' complaint, FERC found that "exempting renewables whose costs exceed the market price would result in the uneconomic entry of renewables and thereby reduce capacity prices."21

<sup>&</sup>lt;sup>17</sup> *Id.*, pp. 4, 5 (emphasis added).

<sup>&</sup>lt;sup>18</sup> PPL Energyplus, LLC, *et al*, v. Solomon, Nos. 13-4330, 13-4394 & 13-4501 (consolidated) 3<sup>rd</sup> Cir.), (Appeal from Judgment of the U.S. District Court for the District of New Jersey, No.3:11-cv-00745-PGS), Brief for the Connecticut Public Utilities Regulatory Authority *et al*, as Amici Curiae in Support of Appellants, at 8.

<sup>&</sup>lt;sup>19</sup> <u>NESCOE v. ISO-NE</u>, 142 FERC ¶ 61,108, Order Denying Complaint, rehearing granted, Apr. 15, 2013.

<sup>&</sup>lt;sup>20</sup> *Id.*, p. 8.

<sup>&</sup>lt;sup>21</sup> *Id.*, p. 35.



These issues are now before FERC on rehearing, where it is expected to again consider whether to exempt wind and solar resources from the MOPR, among other issues.

In the MISO case currently on rehearing, MISO originally had received approval of a voluntary capacity auction, resulting from a stakeholder settlement agreement.<sup>22</sup> Three years later, MISO unilaterally proposed a new Resource Adequacy Construct, one with a mandatory capacity auction for deficiencies. FERC denied this proposal, stating that MISO had not justified the need for a mandatory auction and that FERC did not consider the voluntary auction which it had earlier approved to be a precursor to a mandatory auction.<sup>23</sup> However, in response to applications for rehearing claiming buyer market power, FERC agreed to reconsider whether an MOPR is necessary to prevent buyer market power. It is possible that FERC in its decision on rehearing will make major changes to MISO's resource adequacy construct. It may, among other things, make the voluntary market mandatory by removing the opt-out provision, and add a MOPR to the forward capacity auction. Given the similarities between MISO and California resource adequacy paradigms, FERC's treatment of these issues on rehearing will inform our assessments of the viability and durability of the market mechanism that CAISO designs. Moreover, the outcomes of the MISO and ISO-NE cases will likely influence the CPUC's determination of whether to support or oppose that market mechanism.

Regarding the uncertainty of these cases, there is a timing problem. It makes little sense to expend much time or effort in designing a voluntary residual forward capacity auction through a stakeholder process when we have no clear idea of whether FERC will respect such a stakeholder settlement a few years later or instead decide to make participation in the auction mandatory. It would also be helpful to know whether FERC will require mitigation such as a Minimum Offer Price Rule later on, and if so, whether it will exempt wind and solar resources from application of the rule and under what circumstances. As noted, these issues are currently awaiting resolution by FERC in the MISO and ISO-NE cases. In the best case scenario, we would have final FERC disposition of these cases before designing the market based mechanism.

<sup>&</sup>lt;sup>22</sup> In 2008, FERC accepted MISO's voluntary construct because "[t]he voluntary auction will afford LSEs with an additional mechanism to procure needed capacity and increase transparency in the procurement of capacity." Midwest Indep. Transmission Sys. Operator, Inc., 122 FERC ¶ 61,283 (March 2008 Order), rehearing denied, 125 FERC ¶ 61,061 (Oct. 20, 2008).

<sup>&</sup>lt;sup>23</sup> In re MISO Order on Resource Adequacy Proposal, 139 FERC ¶ 61,199 at p. 3.

At a minimum, ORA encourages the CAISO to include the issues of economic and legal viability within scope, and provide a Straw Proposal market design that clearly acknowledges these issues and addresses them with specific recommendations for risk mitigation. How will the CAISO's proposed market design and stakeholder process address concerns that the market be kept "limited" or "residual," and not become the "de facto" market, a "mandatory" market, or fully centralized market through FERC intervention or third party court challenge? How will CAISO's proposed market design and stakeholder process ensure that California's commitment to preferred resources is not undermined by subsequent changes to the market?

These critical questions regarding economic and legal viability must be addressed early in the CAISO's design of any proposed market mechanism. The CPUC and CAISO jointly committed that "[a]ny CPM replacement mechanism should not inappropriately distort the prices or volume of bilaterally-negotiated capacity contracts or fail to fully recognize resources (preferred or new conventional) that have been procured as a result of or through state policy mandated programs[,]" that "[a]ny CPM replacement mechanism should also not be designed to be or become the primary forward capacity procurement mechanism for LSEs[,]" and that the CAISO and CPUC will "ensure that the format of a backstop procurement market mechanism is durable"<sup>24</sup> Since the JRP makes clear that the CAISO, not the CPUC, will develop the design details of the proposed backstop (and possibly forward) procurement mechanism, the CAISO should anticipate the risks and concerns identified above and address these issues with concrete risk mitigation proposals for stakeholder consideration. This will not be time wasted since the JRP emphasizes that "[t]he details of the proposed design will, however, be significant to any CPUC decisions to modify the existing reliability framework, including supporting or opposing the ultimate form of the backstop as it is designed by the ISO, and the CPUC expressly reserves the right to oppose an ISO filing seeking FERC authority to institute a Reliability Services Auction."<sup>25</sup> If the CAISO does not address these issues through its stakeholder process, it will simply slow down CPUC's consideration of the proposal when it comes before it, since the CPUC's JRP OIR makes clear that the jurisdictional and economic impacts of the RSA are paramount concerns for the CPUC.

<sup>&</sup>lt;sup>24</sup> Joint Reliability Plan, pp. 10-11, emphasis added.

<sup>&</sup>lt;sup>25</sup> *Id.* at Appendix A, p. 10.