



**Comments on the Straw Proposal for Reliability Services**  
**Department of Market Monitoring**  
**July 28, 2014**

The Department of Market Monitoring (DMM) appreciates this opportunity to comment on the straw proposal for the Reliability Services Initiative. While this straw proposal is a good starting point for the initiative, several aspects of the proposal deserve more consideration. In particular, the ISO has not adequately justified core features of the Availability Incentive Mechanism design. We support the ISO considering alternative designs and using more appropriate criteria for their evaluation.

**Availability Incentive Mechanism**

*Single assessment for flexible and generic capacity*

The ISO proposes to combine measurements of compliance with Flexible RA obligations and Generic RA obligations into a single measurement of availability. The measurement of availability will be checked against an availability standard, and resources shall be penalized or rewarded for falling short of or exceeding the standard. The penalty price (in \$/MW-month or equivalent) is the same for all resources, regardless of whether their obligations are to provide Generic RA, Flexible RA or both. A system that treats each obligation separately, measures compliance separately, and has separate penalty prices for the two obligations may have some advantages over the proposed system that combines the two obligations and penalizes shortfalls with the same price.

The ISO describes two primary reasons for using a one price system instead of a two price system. We do not believe either of the ISO's reasons justify the decision to use a one price system.

The ISO's first reason for using a one price system is that a two price system would be less fair and reasonable because it could result in penalizing a single block of capacity twice for the same outage. However, in assessing how fair and reasonable a penalty may be, the total dollar quantity that a generator will be charged for an outage seems to be a more appropriate metric than the number of penalty line items on which the charge occurs. A two price system can be designed so that an outage of overlapping Flexible and Generic RA capacity would face the same total charge under the two price system as it would under a one price system.

Furthermore, the two price system could assess lower penalties for resources that only have one form of RA obligation. The prices for Generic RA and Flexible RA could each be lower in the two price system than in the one price system. Therefore, resources that have only agreed to one of the obligations would see lower penalties than would a resource that has agreed to fulfill both obligations. As a result, the one price system could impose a double penalty on these resources.

The ISO's second reason for using a one price system is that it would be less complex than a two price system. This does not justify using a one price system. First, the two price system could be actually more transparent than the one price system: a two price system results in two numbers instead of one, but each of those numbers would be calculated more transparently than the number in the one price system. Moreover, in market design there is a tradeoff between complexity of implementation and efficiency of market outcomes. The ISO states that the one price system may be more complex than a two price system, but the ISO does not compare the economic merits of the two designs.

The optimal pricing structure for the Availability Incentive Mechanism should be assessed using criteria that are directly related to the Mechanism's core purpose and the impact that the Mechanism may have on the overall efficiency of California's capacity and electricity markets. For example, the Availability Incentive Mechanism's overall structure and the magnitude of the penalty price or prices will directly impact the prices at which generation resources are willing to accept bilateral Flexible and Generic RA contracts. Similarly, AIM's structure and prices will significantly impact the extent to which various resources under RA contracts choose to make their capacity available for the times specified by their RA contracts. We recommend the ISO give more careful consideration to alternative pricing structures by using more appropriate criteria than the ISO used in the straw proposal.

#### *Incentives for following dispatch*

The ISO's AIM proposal appears to penalize or reward availability based simply on whether or not a resource submits bids into the day-ahead and real-time markets. Bid submission alone does not adequately assess the availability of a resource's capacity. We recommend the ISO explore how to incorporate some measure of the resource's performance in following dispatch into its availability metrics.

#### *Resource exemptions*

DMM supports the ISO moving towards a more universal application of the compliance measurement mechanism. Many resources in the fleet are exempt from the existing mechanism (the Standard Capacity Product, or SCP). Designing a new mechanism that eliminates as many of these exemptions as possible should enhance grid reliability and market efficiency.

Under the current mechanism, a scheduling coordinator for a use limited resource may have the incentive to withhold bidding the resource into the market due to the opportunity cost of exhausting the resource's use limitations. Under the new mechanism, scheduling coordinators should have the

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incentive to bid into the market during all hours when the resource could be evaluated for RA compliance. Therefore, they have the incentive to incorporate into the resource's market bids the expected opportunity cost of exhausting the resource's use limitations. As a result, the new mechanism should increase the instances in which the market optimization can incorporate the opportunity costs of exhausting resources' use limitations into the market's optimal commitment decisions. This should enhance the efficiency of market outcomes relative to scheduling coordinators unilaterally deciding to withhold use limited RA resources from participating in the market.