Stakeholder Comments Template

Subject: Reliability Services

Submitted by	**Company**	**Date Submitted**
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This template has been created for submission of stakeholder comments on the Draft Straw Proposal for the Reliability Services initiative that was posted on June 5th, 2014. Upon completion of this template please submit it to RSA@caiso.com. Submissions are requested by close of business on **June 26th, 2014**.

ORA provides the following comments on "Part 2: Availability Incentive Mechanism," and "Part 4: Capacity Procurement Mechanism":

2. Please provide feedback on Part 2: Availability Incentive Mechanism.
    a. Comments on the general direction of the design

       The purpose and general direction of the design appropriately addresses evolving reliability needs. ORA voices some general concerns in the following comments.

    b. Comments on design features
        i. Bid-based assessment

           The California Independent System Operator's (CAISO) Straw Proposal is not clear on the potential outcomes for gas-fired resources versus the outcomes for preferred resources under the bid-based assessment.[1] The CAISO proposes to calculate a resource's availability by comparing the MWs that the CAISO expected to be available to the MWs that were economically bid or self-scheduled into the CAISO market. Under this proposed bid-based assessment metric, use-limited resources (i.e., preferred resources) will be treated more like non-use limited resources (i.e., gas-fired resources). This may result in a shift that favors the more flexible gas-fired resources, especially those with newer technologies. Caution should be taken with the new assessment to avoid disadvantaging use-limited resources in either generic or flexible capacity availability. Similarly, the use-limited resources should not be disadvantaged in the CAISO's proposed rewards and penalty incentives. The CAISO proposes that resources that are more than 2.5% above the CAISO's availability standard would be eligible for an availability reward payment, while resources with availability less than 2.5% below the availability standard would be subject to a penalty charge. This reward and penalty incentive mechanism should not increase availability rewards for gas-fired generation without providing equally attainable incentives for preferred resources.

While the CAISO strives to be technology agnostic, the proposed resource availability calculation methodology may require modifications so that preferred resources are allowed and encouraged to reach their maximum potential to provide flexible capacity. In order to guide the development of the best metrics for assessment of availability incentives, ORA requests that the CAISO provide data on the projected reward and penalty payments by resource type under the new Availability Incentive Mechanism (AIM).

ii. Fixed availability percentage band

ORA supports in principle the CAISO's proposal to create an availability incentive standard percentage band assessment for individual resource availability. This band is intended to adapt to future grid need and create a self-funding mechanism.[2] ORA recommends that the CAISO provide an analysis to indicate if cost-shifting from preferred resources to non-preferred resources may occur with the fixed band.

iii. Single assessment for flexible and generic overlapping capacity

iv. Other features

[1] Reliability Services Straw proposal, June 5, 2014, pp. 28-32.

[2] Reliability Services Straw proposal, June 5, 2014, pp. 38-40.

c. Comments on price

ORA supports the CAISO proposal to include an offer cap both as a mitigation measure and a price for the AIM.[3] The offer cap price and AIM price would be the same price and would be best reflected by an average capacity contract price derived from information provided to the CAISO by the California Public Utilities Commission (CPUC).

The CAISO proposal recommends a fixed price for system, local, and flexible capacity. The CAISO notes uncertainty over the future of flexible capacity prices and asserts that flexible capacity may not require a premium. However, the CAISO does not dispute the significant premium currently paid for local capacity. ORA recommends consideration of the potential benefits of utilizing a separate price, based on contract prices, for local capacity rather than the proposed single price for all capacity. Since local capacity commands higher prices based on its increased demand, there may be a reliability benefit to offering higher incentive prices for local capacity. A higher local capacity incentive would create greater incentives for the more valuable local resources to perform routine maintenance, thus reducing unexpected outages.

d. Comments on capacity and resource exemptions

ORA supports the CAISO's proposal to re-evaluate which resources are exempt in the revised availability incentive mechanism.[4] Under the current availability incentive mechanism many resources are exempt due to their inability to comply with must-offer requirements. The CAISO proposes to reduce the amount of exemptions by more narrowly defining the resources that are physically or uniquely unable to fully comply with their must-offer requirement. This process will likely be controversial and result in a significant impact on resources which are granted or denied exempt status. Accordingly, ORA recommends that this re-evaluation include stakeholder workshops and multiple comment opportunities, and should be conducted in cooperation with the CPUC.

e. Other Comments

ORA appreciates the CAISO's efforts to develop this complex revision to the existing incentive mechanism and looks forward to participating in this additional effort to address the changing power system.

4. <u>Please provide feedback on Part 4: Capacity Procurement Mechanism.</u>

   a. Comments on index price

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[3] Reliability Services Straw proposal, June 5, 2014, pp. 40-41.

[4] Reliability Services Straw proposal, June 5, 2014, pp. 41-44.

Option one ("use information provided by the CPUC from the RA bilateral market to establish the price for backstop capacity"[5]) is a transparent, market-based solution for determining a CPM (Capacity Procurement Mechanism) price and should not be dismissed. Transparency exists in the California Resource Adequacy (RA) construct. Load Serving Entities (LSEs) obtain pricing information through the bilateral market or competitive Requests for Offers (RFOs), and the CPUC collects and compiles pricing (and other) information for the IOUs' RA contracts. Transparency could be enhanced, for example through the publication of a CPUC-CAISO joint long-term reliability assessment, in collaboration with the CEC, as envisioned in the Joint Reliability Plan (JRP) agreement.

The CAISO's Straw Proposal describes four reasons why it may be difficult to proceed with Option One.[6] First, the CAISO asserts that because there is significant variation in bilateral RA contracts, a price in one contract may not be comparable to another. That may not be the case, particularly given the significant supply of capacity in California which makes it likely that a sufficient supply of similar capacity is available for purposes of price determination. Furthermore, as the must-offer and eligibility requirements are increasingly standardized, it is reasonable to assume that the supply of comparable RA contracts will also increase.

Second, the CAISO is concerned that "if a price is derived from multiple LSE procurement processes, it may no longer be reflective of a specific, transparent process."[7] While LSEs do have separate procurement processes, <u>the price paid for capacity is market-based — determined in bilateral markets either through direct bilateral contracting or through an RFO process</u>. The CPUC reported RA prices could be used to determine an appropriate CPM price that would be tied to changing market conditions.

Third, the CAISO notes that "the price paid in a bilateral market will most often not represent the price required to secure what capacity remains available."[8] But it may well be reasonable to pay a premium for backstop capacity over the price of similar capacity contracted in the bilateral market. For example, a multiple of a rolling average of historic reported RA prices could be created to adequately take into consideration the premium necessary to secure backstop capacity.

Fourth, the CAISO assumes that "it would not be possible to ensure that the bilateral contract price is reflective of system conditions and capacity available proximate with the time of the CPM designation."[9] In reality, the bilateral market prices fluctuate over time taking into account changing system conditions and the amount of capacity available to meet reliability needs. The

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[5] Reliability Services Straw proposal, June 5, 2014, p. 58.

[6] Reliability Services Straw proposal, June 5, 2014, pp. 58-59.

[7] Reliability Services Straw proposal, June 5, 2014, p. 58.

[8] Reliability Services Straw proposal, June 5, 2014, p. 59.

[9] Reliability Services Straw proposal, June 5, 2014, p. 59.

bilateral market prices also take into account forecasted changes in system conditions, such as planned resource additions and retirements. In short, bilateral contract prices retain aspects of the system conditions and capacity available in the future, when backstop procurement may be needed.

b. Comments on competitive solicitation process

i. Annual backstop designation process

The CAISO's Straw Proposal states:

> "The initial offers for annual CPM backstop would be due at the same time as the compliance showing. During the cure period, the market participant would have the option to remove any previously offered capacity if it was subsequently sold or otherwise no longer available as backstop RA capacity. In the event of a deficiency for annual capacity, the ISO would run the annual CPM designation tool to procure needed capacity and pay any procured capacity their offer price."[10]

ORA agrees that it is reasonable to give sellers the option to remove offers if previously offered capacity was subsequently contracted bilaterally with an LSE for purposes of curing a potential deficiency. However, ORA seeks clarification regarding the option for sellers to remove offered capacity if it was "otherwise no longer available as backstop RA capacity." Under what circumstances would offered capacity be deemed no longer available as backstop capacity? ORA recommends that sellers not be allowed to remove offered capacity at will because this may create a gaming opportunity where low-priced offers are submitted and subsequently withdrawn, leaving only a few high-priced offers remaining. In addition, ORA seeks clarification on how the CAISO proposes to backstop any deficiency in the event that the competitive solicitation produces no offers or all offers are removed by sellers.

ii. Monthly backstop designation process

ORA recommends the following changes to the language in the CAISO's Reliability Services Straw Proposal:

> "Offers would have their price locked until after seven days prior to the next month; however, suppliers would have the opportunity to completely remove their offer from the competitive solicitation

[10] Reliability Services Straw proposal, June 5, 2014, p. 62.

> process if and only if ~~in the event~~ they were able to bilaterally contract the capacity."[11]

In addition, ORA seeks clarification on how the CAISO proposes to backstop any deficiency in the event that the competitive solicitation produces no offers or all offers are removed by sellers.

iii. Exceptional dispatch and significant event backstop designation process

The CAISO's Straw Proposal states:

> "The ISO proposes to use offers from the monthly competitive solicitation process if it must designate a resource under an exceptional dispatch or significant event CPM. These offers will be locked in from 45 days prior to the month and may only be removed after seven days prior to the month."[12]

It is unclear why the CAISO is proposing to allow offers to be removed after seven days prior to the month. If all offers are indeed withdrawn after seven days prior to the month and there is a need for exceptional dispatch or significant event backstop within the seven days until the next RA month, there would effectively be a seven day window with no offers to select for CPM designation.

In addition, ORA seeks clarification on how the CAISO proposes to backstop for significant event and exceptional dispatch if the competitive solicitation does not result in any offers.

iv. Risk-of-retirement backstop designation process

At the May 13, 2014 JRP workshop the CAISO indicated that it would seek to remove the risk-of-retirement CPM designation if multi-year RA is adopted by the CPUC. ORA supports the CAISO's stated intention. "Risk of retirement" considerations, which are forward in nature, are best addressed 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 in transmission constrained local areas and/or capable of providing flexible capacity. Developers of the CPM 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

[11] Reliability Services Straw proposal, June 5, 2014, p. 63.

[12] Reliability Services Straw proposal, June 5, 2014, p. 64.

support forward-year reliability concerns.

For purposes of the Reliability Services Initiative (RSI) Phase 1 CPM mechanism, ORA is concerned that there is a potential for gaming in the risk-of-retirement backstop designation process. It appears that resources could submit excessively high bids in the competitive solicitation to ensure that they do not clear, and then plead for risk-of-retirement designation. The potential for gaming could be mitigated through awarding resources designated as at risk of retirement a cost-based price rather than their annual competitive solicitation offers.

c. Comments on other changes potentially needed to CPM

The CAISO's straw proposal states that "if the CPUC adopts a multi-year requirement to their RA program, the ISO would then initiate a stakeholder process to consider adding another CPM designation category in circumstances where LSEs procure insufficient multi-year forward capacity."[13] ORA seeks clarification on two issues regarding this statement. First, it is unclear whether, if the CPUC adopts multi-year RA requirements, the CAISO plans to keep the backstop procurement mechanism that will be adopted in Phase 1 of the RSI and consider adding to it another CPM designation category for insufficient multi-year forward capacity, or whether the CAISO would propose, in Phase 2 of the RSI, a different backstop procurement mechanism. Second, it is unclear whether CAISO's consideration of adding another CPM designation category for insufficient multi-year forward capacity would backstop up to the capacity percentage requirements established under the CPUC multi-year RA framework or up to 100% of capacity forecasted needs. In other words, what is the definition of insufficient multi-year forward capacity? ORA recommends that the CAISO provide clarification on these two issues in response to comments and in the next iteration of the Reliability Services proposal.

Even if the CPUC adopts a multi-year RA framework, it is not apparent that backstop capacity procurement should operate in the same forward timeframes as the CPUC's RA framework. In fact, a successful multi-year RA program should minimize the need for backstop procurement. A multi-year RA program would secure additional capacity over a longer timeframe when compared to the existing RA program. Therefore, it appears counter-intuitive that CAISO is proposing to increase the frequency and timeframe of backstop procurement if a multi-year RA framework is implemented. A well-designed backstop procurement mechanism should be used infrequently. For example, a complementary backstop mechanism may primarily serve to secure intra-monthly capacity to meet system, local and flexibility needs. In addition, the backstop mechanism could maintain its current role of securing capacity in short time frames for exceptional dispatch, in response to exceptional events.

[13] Reliability Services Straw proposal, June 5, 2014, p. 60.

d. Comments on CPM price

e. Comments on supply-side market power mitigation measures

i. Limits on bidding flexibility within the competitive solicitation process

ORA agrees that it is reasonable to require that a supplier offer capacity at a price before a deficiency is determined.[14] If a deficiency were determined prior to suppliers submitting offers, or if suppliers were allowed to change their price after a deficiency is determined, suppliers would be able to exercise market power. For example, if suppliers knew that a deficiency was determined before offers were due and their resources were needed to cure that deficiency, they would be able to extract higher rents from the competitive solicitation process.

ii. An assessment of market power within the competitive solicitation process

ORA agrees that, in addition to limits on bidding flexibility, a three-pivotal supplier test[15] should be conducted for every solicitation to evaluate both local market power and capability market power.[16]

iii. An offer cap on all capacity offers

If suppliers fail a three-pivotal supplier test, they should be subject to a cost cap on their bid. It is reasonable to derive an offer cap using bilateral market data provided by the CPUC. ORA notes that offer caps should not be made public well in advance of the CPM competitive solicitation. If such offer caps were made public ahead of time, then resources with costs significantly less than the offer cap might opt to not enter into bilateral agreements with LSEs; rather they might wait for the CPM competitive solicitation and submit a bid that is close to the offer cap, potentially low enough to ensure they clear, but much higher than their marginal cost.

f. Comments on demand-side market power mitigation measures

g. Other comments

ORA recommends that the CAISO include the option of seeking FERC's approval to extend the existing administratively-priced CPM mechanism as "Option three" in its forthcoming Phase 1 RSI revised straw proposal.

[14] Reliability Services Straw proposal, June 5, 2014, p. 65.

[15] The three pivotal supplier test measures the degree to which the supply from three generation suppliers is required in order to meet the demand to relieve a constraint. (http://www.monitoringanalytics.com/reports/Presentations/2007/20070727-tps.pdf.)

[16] Reliability Services Straw proposal, June 5, 2014, p. 65.

The CAISO has stated that a market-based backstop mechanism is necessary in order to replace the current CPM's administratively determined price with a transparent, market-based price. As ORA and other stakeholders including Pacific Gas and Electric Company (PG&E) have noted, replacing the existing CPM with a market-based mechanism is not a Federal Energy Regulatory Commission (FERC) mandate.

CPUC staff has urged "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."[17]

Several stakeholders commented on the viability of continuation of the current CPM as an option for the CAISO to consider in the forthcoming straw proposal. As previously noted, FERC has not mandated replacing the existing CPM with a market-based alternative. The CAISO can and should consider the option of extending the CPM.[18] Independent Energy Producers (IEP) recommended that the CAISO "seek FERC's approval to extend the existing CPM mechanism."[19] Southern California Edison Company (SCE) stated that market solutions are preferred only if the conditions for competitive markets exist.[20] It is unclear that the conditions needed to support a market-based backstop mechanism exist. Therefore, ORA recommends that the CAISO include the option of seeking FERC's approval to extend the existing administratively-priced CPM mechanism as "Option three" in its forthcoming Phase 1 RSI revised straw proposal.

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[17] CPUC Staff comments, March 11th, 2014, p. 3.

[18] PG&E's Reliability Services Issue Paper comments, February 18, 2014, p. 5.

[19] IEP's Reliability Services Issue Paper comments, February 18, 2014, p.1.

[20] SCE presentation at February 24 CAISO RSI working group meeting, p. 1, available at: http://www.caiso.com/informed/Pages/StakeholderProcesses/ReliabilityServices.aspx