

Comments of Pacific Gas and Electric Company ***Reliability Services Initiative – Issue Paper***

Submitted by	Company	Date Submitted
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Pacific Gas and Electric Company (PG&E) offers the following comments in the stakeholder process for the California Independent System Operator’s (CAISO) Reliability Services Initiative (RSI) Issue Paper.¹

PG&E’s primary comments are:

- 1) PG&E agrees that the Capacity Procurement Mechanism (CPM) replacement needs to be addressed now.
- 2) The CAISO should clarify how its schedule and plan aligns with the related California Public Utilities Commission (CPUC) proceedings and milestones.
- 3) The CAISO should work with stakeholders to define the reliability problem it should solve to ensure this initiative’s scope addresses the correct issues.
- 4) CAISO should allow stakeholders to vet all reasonable market design alternatives; approaches from other ISOs should inform the RSI.
- 5) The Phase 1 scope is likely too aggressive for the CAISO’s proposed timeframe.

1. PG&E agrees that the CPM replacement needs to be addressed now.

It is appropriate for the CAISO to have a backstop reliability tool like the CPM. CPM deliberations alone will likely be complex and time-consuming. Past CPM discussions have involved settlement discussions and lengthy Federal Energy Regulatory Commission (FERC) approval periods. PG&E recommends CAISO

¹ <http://www.aiso.com/Documents/IssuePaper-ReliabilityServices.pdf>

prioritize a plan to replace or extend existing core reliability functions that could be lost with the expiration of the CPM in February 2016.

2. The CAISO's plans should align with related CPUC proceedings and milestones as well as address the planning processes of all Local Regulatory Authorities (LRAs).

PG&E believes that CAISO's consideration of the CPUC proceedings is consistent with the general spirit of the Joint Reliability Plan (JRP) and supports the CAISO's proposed principle of LRA alignment.

The CPUC holds an important role in capacity planning. To ensure reliability at lowest cost and reduce regulatory complexity, the CPUC and CAISO rules for capacity planning should be consistent. For example, if CPUC-directed procurement fails to satisfy the CAISO's reliability needs (under reasonable circumstances), ratepayers may face additional procurement costs. PG&E seeks to avoid this excessive cost by aligning CPUC and CAISO rules to the extent possible.

PG&E anticipates that CAISO-CPUC alignment will be critical for the following CPUC proceedings: the JRP Rulemaking² Tracks 1 and 3, and the ongoing Resource Adequacy (RA) Rulemaking.³

In the CPUC's JRP Order Instituting Rulemaking (OIR) Track 3, the Commission will develop a formal policy position on the CAISO's proposal for a market-based mechanism to replace or augment CPM. This CPUC decision could also be accompanied by specific rules informing CPUC-jurisdictional Load Serving Entities' (LSEs) participation in CAISO's market mechanism, to the extent possible under CPUC's jurisdiction. Given this dynamic, the CAISO should include in its Phase 1 timeline more detail on how it plans to coordinate the RSI Phase 1 schedule with CPUC's JRP OIR Track 3 schedule. A formal commitment to CPUC-CAISO workshops, for example, would lay the foundation for stronger alignment with LRAs.

Regarding JRP Track 1, which will consider multi-year RA procurement requirements, a CPUC decision is expected in February 2015.⁴ The CAISO should

² The Order Instituting Rulemaking (R.14-02-001) To Consider Electric Procurement Policy Refinements Pursuant To The Joint Reliability Plan was approved by the Commission on February 5, 2014.

³ R.11-10-023.

⁴ R.14-02-001, p. 20.

align its RSI Phase 2 schedule to the expected CPUC schedule. For example, does the CAISO intend to wait to begin Phase 2 until after CPUC makes a final a decision on multi-year RA? What are the CPUC milestones that will initiate the RSI Phase 2?

3. The CAISO should first work with stakeholders to define the reliability problem to ensure this initiative's scope addresses the correct issues.

At a high level, the CAISO lays out the continuing energy landscape transformation, more use-limited resources coming online, and the displacement of traditional resources as necessitating durable backstop procurement capabilities. The CAISO should provide more details about the specific reliability needs underlying each of the six items that the CAISO defines as in scope for the RSI.⁵

Without fully laying out the CAISO needs and the scope of the issues, we find it difficult to address exactly what elements are needed and how complex a solution should be developed to address the CAISO's reliability needs. During the Flexible Resource Adequacy Criteria and Must Offer Obligation (FRAC-MOO) initiative, a critical assessment of the flexible capacity needs⁶ emerged late in the stakeholder process, dramatically re-routing and better informing the design efforts. This outcome highlighted how a more rigorous review of the CAISO's challenges yielded a more appropriate consideration of solutions. PG&E looks forward to working with the CAISO to detail the specific problems associated with standardization, CPM replacements, and incentives that the CAISO seeks to resolve.

Such information would help address questions including:

Why does the CAISO seek to further standardize capacity products? What reliability needs would be addressed by each of the standardized products?

⁵ 1) Enhance the minimum eligibility criteria for system, local, and flexible RA capacity where needed. 2) Modify must-offer rules where required, in particular for use-limited resources, in order to standardize must-offer requirements for different technology types, as is feasible. 3) Create a durable CPM pricing market mechanism that would replace the current administrative price when it expires in February 2016. 4) Synchronize replacement and substitution rules with the new CPM pricing market mechanism as required. 5) Modify or create new incentive mechanisms for energy market participation for system, local, and flexible capacity. 6) Update the CPM to include multi-year backstop authority as well as evaluate the risk-of-retirement designation in the context of a multi-year forward RA procurement requirement.

⁶ In the CAISO's Fifth Revised Straw Proposal, the CAISO officially introduced the idea of categories of must-offer obligations and capability requirements. An analysis of the CAISO's needs proved useful and is referenced in these comments to emphasize the value of fully breaking down the problem, when feasible, prior to pursuing a market design.

Is a voluntary market mechanism (VMM) necessary to address this potential problem?

Can CPUC adjustments to the RA program adequately mitigate some of the CAISO's reliability concerns?

4. CAISO should avoid a full design effort on a single solution or idea until stakeholders have had the opportunity to understand system needs and consider all reasonable options. Ideas and approaches from other markets should inform the RSI.

PG&E appreciates the CAISO's continued efforts to put forth design ideas for stakeholder review. As previously stated, given the large scope of the RSI and array of solutions, PG&E believes the CAISO should first focus on simple solutions to address the core needs of the CPM expiration. In this phase, the CAISO should expand the number of potential solutions it identifies to address various topics to allow for review and input by stakeholders prior to detailing a specific design concept.

This approach will allow for discussion, analyses, and assessments of possible approaches, so that stakeholders can consider the most reasonable path after a CPM replacement has been developed. For example, the CAISO has mentioned that a VMM will likely be part of its design. PG&E does not understand the benefits of a voluntary market combined with a subsequent mandatory market. There should be more of a robust discussion of the merits of having both mechanisms in place prior to moving forward with a design that includes both. The ISO notes that the VMM could provide a means for soliciting capacity bids subsequently used for a mandatory "cure" auction. Even with the voluntary bid submission, the mandatory auction may still require market power controls, such as the use of proxy capacity bids. Since these items will be developed with or without a VMM, stakeholders might just prioritize these latter aspects and consider the role of VMM at a later date. Stakeholders should compare the VMM approach with other approaches that meet the same reliability objectives before focusing exclusively on a design that includes a VMM.

Likewise, multiple capacity auction designs should be considered, including an annual-only auction, before contemplating a full suite of annual, monthly, and intra-month auctions using the same market mechanism. An array of market power solutions should also be considered. If a preliminary assessment of certain

approaches appears unreasonably complex and unwieldy, stakeholders may prefer simpler solutions. Additionally, if the CAISO and stakeholders encounter complex design issues deep into the design process for a particular approach, knowledge of the alternative pathways will inform parties on whether to abandon a design effort in pursuit of an alternative path or to instead strive to work through the difficult design aspects.

Additionally, CAISO should not reinvent the wheel in the RSI. Several different iterations and methods of capacity planning have been conducted in the different RTO markets, including PJM, MISO, ISO-NE, and NYISO. MISO originally adopted a purely voluntary market with penalties for noncompliance, while the eastern markets all adopted various shades of mandatory markets, with mandatory participation both by loads and generators, with tight market power rules on both the load and generation side. An evaluation of the capacity procurement methods used in these areas and identification of lessons learned would provide information to guide us going forward.

5. The Phase 1 scope is likely too aggressive for the CAISO's proposed timeframe and the CAISO should focus first on narrow reforms around the CPM deadline.

While PG&E supports the CAISO's phasing idea for the RSI, the Phase 1 scope is ambitious given the proposed timeframe.⁷ The CAISO should either develop a longer timeframe or preferably reduce the Phase 1 scope to only consider the essential issues and simple solutions.

The CAISO may have an ability to pursue non market-based pricing mechanisms for the CPM. Upon review of FERC's Order on the Flexible and Local Reliability Retention mechanism – a tool proposed by the CAISO to manage risk-of-retirement concerns for resources deemed to be “needed” between two and five years into the future – FERC's desire for a market-based pricing mechanism for planning capacity does not constitute a mandate.⁸ Stakeholders should consider whether it would be preferable to have a near-term extension for the CPM (or equivalently simple measure) to address the reliability needs the CAISO will likely face while the RSI

⁷ The RSI issue paper identifies an expected Board of Governors decision on phase 1 in December 2014 or Q1 2015. See p. 9.

⁸ FERC's order states: “...we encourage CAISO and its stakeholders to focus on the development of a durable, market-based mechanism that provides incentives to ensure that resources with the adequacy and operational needs CAISO requires are available to meet system needs”. FERC Docket ER13-550-000, “Order On Tariff Revisions”, March 29, 2013, p. 68.

explores more widely-scoped solutions to capacity tools and rules. CAISO data shows the CPM has been used very infrequently and complex market solutions may be unnecessary given the scope of such a tool.⁹ Also, the costs associated with CPMs may not warrant a complex solution.¹⁰ Given the planned timeframe and small scope of the problem, the CAISO and stakeholders should consider a simple plan to replace the CPM.

⁹ Based on PG&E analysis of CAISO CPM designation reports, the CPM was used only twice in 2013.

¹⁰ PG&E notes that the Department of Market Monitoring's Market Performance Reports routinely highlight the millions of dollars of costs associated with congestion uplift as a market issue. Perhaps a prioritization based on cost-impacts is more appropriate for prioritizing stakeholder efforts.

<http://www.caiso.com/Documents/2012AnnualReport-MarketIssue-Performance.pdf>