Southern California Edison's Stakeholder Comments

Reliability Services Initiative Working Group 3/27/14

Submitted by	Company	Date Submitted
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Please find Southern California Edison (SCE) comments on the March 27, 2014 Reliability Service Initiative (RSI) working group. SCE appreciates the CAISO's efforts to work with stakeholders to explore issues related to the replacement of CPM, and for possible market based mechanisms for capacity procurement. SCE offers comments on the following:

- SCE disagrees with CAISO characterizations that a voluntary auction must be developed
- An understanding of liquidity and participation will have material implications on any ultimate market design
- Under any design, some form of administrative pricing will be needed for CPM
- New CAISO markets must interact with other RA processes; any potential market must address these potentially complex interactions
- At this stage, the CAISO should only explore a simple voluntary "system/local" auction; the interim FRACMOO proposal should not be the basis for a "flexibility" auction design
- Questions on the CAISO's structure for a "flexibility" auction

1. A Voluntary Capacity Auction is Not a Mandate; Alternatives are Available

During the workshop, the CAISO stated (page 47) and left the impression they had no option but to develop a voluntary capacity auction. While SCE understands the potential benefits of this model, other options remain viable. Moreover, potential restrictions on participation, and the requirement for an administrative price determination for CPM under any design (discussed below) may ultimately make other options more attractive. Other options for CPM include the continuation of an administrative price, linkage to bilateral pricing, or the use of a market proxy[1] (that does not require running an auction).

[1] For example, similar to how PJM determines mitigated capacity bid offers, the CAISO could construct a competitive capacity bid curve. The CAISO could use this supply curve matched against demand to guide the value of a market proxy for the CPM capacity price.

2. Any Auction Design Must Address Uncertain Liquidity

The CAISO rightfully explored issues of liquidity and its potential impact on both voluntary and mandatory (backstop) auctions. SCE notes a host of uncertainties could materially impact auction liquidity including LRA restrictions on participation, the voluntary nature of the design, forward procurement/contracts that may hinder auction participation, uncertainty over auction performance, and potential risks/costs unique to the auction that may make it unattractive. This is particularly true since SCE expects, consistent with the RSA, the current CPUC bilateral RA process will continue for the foreseeable future as the predominate mechanism for securing capacity.

Uncertain liquidity creates significant design challenges. For a voluntary auction, simple rules, such as requiring minimum participation as a condition of running the auction, could be considered. However, any attempt to use the auction results or bids to inform CPM prices (e.g. the "mandatory auction") requires far more rigorous treatment. Without certainty of competitive bidding, the CAISO cannot simply use the auction to determine CPM prices. The CAISO ultimately compels market participants to pay CPM rates, and FERC has a statutory obligation to ensure just and reasonable rates. Any auction process requires comprehensives market power mitigation and other structures before the CAISO could use it as the basis of CPM pricing.

3. Under any Design, Some Form of Administrative Pricing will be Needed for CPM

While an auction may ultimately prove robust and competitive, the CAISO's design must address situations that produce less favorable results. For example, if the auction is voluntary, what happens if generation chooses not to participate? How can a "null auction" inform CPM prices?

SCE concludes that, to address all potential outcomes, the CAISO will have to develop some form of administrative process to determine CPM prices, at a minimum, to cover a potential auction failure. As a result, developing an auction does not remove the necessity to develop some form of administrative CPM pricing.

4. Any New CAISO Markets Must Interact with other RA Processes

Any CAISO market that interacts with the current RA process must be coordinated both at the CAISO and the CPUC. Since the CAISO proposes to be the counterparty to all auction transactions, load will not know their counter party. This creates new issues for RA showings. For example, replacement obligations and non-performance obligations will likely have to transfer to resources that clear the auction since load has no direct relationship or recourse over such units. If the auction runs close to delivery, this may not be a material change from the status quo. However, if the auctionruns months in advance, resources will have to assume additional replacement risk. Moreover, the basic rules for resources that sell in the auction and then fail to deliver require development.

Also, the process to flow auction results to the CPUC (for showings) requires definition. Load buying from the auction will not know their counterparty but nevertheless needs some mechanism for the CPUC to recognize and properly credit these purchases in their compliance showings. SCE expects a host of additional CAISO/CPUC linkage issues and CAISO RA rules will require modification in the context of any new auction design.

5. A Simply Voluntary "System Auction" Without "Flexibility" Should be Considered at this Time

Per our previous comments, SCE notes that no other ISO has a "flexibility" requirement as part of their RA or capacity market design. Flexibility, as a concept, is unproven and may ultimately be shown to be unworkable or undesirable. More specifically, stakeholders designed and SCE largely supported the FRACMOO tariff as 1) an interim device, and 2) for use in the context of a CPUC bilateral RA system. SCE never agreed to translate FRACMOO into a centralized capacity structure, nor did the design process address this path. SCE strongly questions the reasonableness of attempting to port this interim FRACMOO design into a fully centrally capacity auction, be it voluntary or mandatory.

We note that several other ISO/RTOs have capacity markets that can provide material guidance to the CAISO process, but none procures "flexibility". By including Flexiblity in the auction, the CAISO will have tackle difficult issues, such as the appropriate means to mitigate flexibility bids (or whether or not to allow such bids), general capacity unbundling issues, participation qualifications, restrictions and obligations, and a host of other complications.

Moreover all this complexity requires resolution even if the CAISO never needs to procure the flexibility in this interim period.

Particularly in light of the existing bilateral structure and liquidity concerns noted above, its interim nature, and its intended bilateral use, SCE encourages the CAISO to remove "flexibility" from the current auction design process. The CAISO should first refine and prove the core concept of "flexible" capacity in the bilateral-pace before even considering adding additional layers of complexity to an already challenging auction design process. Instead, at this stage the CAISO should focus exclusively on a core auction structure strictly for system (and possibly local) capacity.

6. Questions on the CAISO's Structure for a "Flexibility" Auction

While we do not support moving forward, SCE nevertheless seeks clarification on the CAISO's intent with the "flexibility" auction. First, does the CAISO expect that resources will submit potentially five different bids (for the same resources) into the auction (system, local, Flex 1, Flex 2, Flex 3)? That is, does the CAISO desire to fully unbundle and produce separate prices for each variation of capacity? Or, rather, does the CAISO expect the unit will represent their intrinsic capability to the auction, and constraints in the auction will produce shadow prices without the need for resources to supply separate bids?

What "qualification" process will the CAISO use before allowing parties to submit various types of flex bids? How will the RA showings be incorporated into the auction process? For example, assume LSE_A is long Flex 1, LSE_B is short Flex 1, but in aggregate the CAISO has sufficient Flex 1 - what will the auction do? (Will it buy nothing? Will it effectuate a sale from LSE_A to LSE_B? Will it maintain LSE_A's portfolio and purchase additional Flex 1 elsewhere to satisfy LSE_B's deficiency?) Who determines the capabilities of resources and how do the CPUC and the CAISO ensure the same metrics/qualifications are applied consistently through both the bilatleral and the CAISO auction mechanism?