September 5, 2014

COMMENTS ON BEHALF OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA REGARDING THE REVISED STRAW PROPOSAL ON RELIABILITY SERVICES

In response to the ISO's request, the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, the "Six Cities") submit the following comments regarding the August 11, 2014 Revised Straw Proposal on Reliability Services (the "Revised Straw Proposal").

The Revised Straw Proposal addresses numerous issues relating generally to implementation of Resource Adequacy requirements for generic and flexible RA capacity. The Six Cities support many elements of the Revised Straw Proposal but have questions or concerns regarding several aspects of the Proposal. The Cities' comments below address three general topics covered by the Revised Straw Proposal: (i) application of the Availability Incentive Mechanism ("AIM"), (ii) elements of the AIM, and (iii) replacement and substitution rules.

Application of the Availability Incentive Mechanism - -

The Six Cities support the ISO's proposal (Revised Straw Proposal at 39-40) to exclude from the availability calculation process use-limited resources that have reached or passed applicable use limitations, including (but not limited to) daily, monthly, or annual restrictions on number of starts or operating hours.

The Six Cities oppose the ISO's proposal (Revised Straw Proposal at 40) to rescind the exemption from availability penalties/payments for currently grandfathered resources subject to resource-specific contracts entered into prior to June 28, 2009. The currently effective exemption for grandfathered resources has been in place since the initial implementation of availability standards, and the ISO has not presented any evidence that the exemption has resulted in any impairment of system reliability. In the case of the Cities, many of the grandfathered resource contracts were executed long before the establishment of RA requirements and even prior to the establishment of the ISO. The grandfathered resource exemption appropriately recognizes that contracts entered into prior to the adoption of availability standards may give rise to additional risks or challenges to avoiding penalties. Renegotiating such contracts at a minimum would impose substantial burdens on LSEs and may not even be possible. The ISO should continue to respect pre-existing contractual commitments and limitations and should keep the exemption from availability penalties/payments for grandfathered resources in place unless and until there is a compelling reason, based on a demonstrable reliability concern, to revoke the exemption. The ISO has not demonstrated that such a reason exists.

At page 40 of the Revised Straw Proposal, the ISO states that some use-limited resources that do not have calculable opportunity costs may be exempted from AIM through a review of use plans and requests stakeholder input on the types of use-limitations that may require an exemption. The Six Cities recommend that small hydro resources and landfill gas generators be included in the exemption from the AIM. Small hydro resources are self-scheduled based on

water demand, and landfill gas generator output is dependent on the gas flow from the landfill gas supply system. Calculating the opportunity costs for these types of resources is problematic due to the variable nature of the fuel supply.

In addition, the ISO indicates (Revised Straw Proposal at 40) that it will consider exemptions from the AIM on a resource-specific basis. Two of the Six Cities (Pasadena and Riverside) require the use of internal generation facilities during peak load periods to maintain local reliability as a result of limitations on their ability to import into their UDC areas sufficient energy to serve their maximum loads. To the extent their internal resources are designated for System or Local RA capacity, the Cities assume that self-scheduling such resources would meet the availability test. Where such resources are designated as Flexible RA, however, they should be exempt from the availability assessment process during periods when they must be used to maintain local reliability. Because the ISO's need for flexible capacity generally does not occur during system peak conditions (which is when the Cities' internal resources are most likely to be needed for local reliability), the impact of such an exemption on the availability of the affected resources to meet flexibility requirements should not be significant.

Elements of the Availability Incentive Mechanism - -

The Six Cities specifically support the following proposed elements of the AIM:

- Maintaining the currently effective five-hour availability assessment period for generic capacity (Revised Straw Proposal at 24);

- Monthly assessment of availability performance (Revised Straw Proposal at 24-25);

- The proposal that payments to resources for availability more than 2% above the average be funded exclusively through charges to resources for availability lower than 2% below the average (Revised Straw Proposal at 33-34);

- The proposed availability incentive price of $3.50/kW-month (Revised Straw Proposal at 36), which the Cities suggest should be subject to adjustment every two years based on changes in prices for RA capacity as reported by the CPUC; and

- The proposed cap on availability incentive payments of two times the availability incentive price and distribution to load of excess funds remaining at the end of each year (Revised Straw Proposal at 36, 41).

Replacement and Substitution Rules:

The Six Cities support the ISO's objectives of simplifying and clarifying the rules for replacement or substitution for RA capacity that is unavailable due to planned or forced outages. In general, the Cities support the ISO's recommendations to eliminate the distinction between replacement (currently applicable to planned outages) and substitution (currently applicable to forced outages) and to address replacement/substitution requirements on a single, sequential timeline. Indeed, the Cities urge the ISO to undertake comprehensive reform of the

replacement/substitution process without delay. However, as discussed below, certain recommendations in the Revised Straw Proposal are unclear or unduly restrictive and should be revised.

The Six Cities agree that the complexities and defects in the current replacement/substitution process summarized at pages 51-59 of the Revised Straw Proposal engender confusion, inconsistent treatment of resources, and unnecessary procurement, and that the process should be reformed. However, the ISO's proposed implementation of different replacement/substitution rules for the 2016 RA Year, the 2017 RA Year, and the 2018 RA Year is hopelessly confusing and inconsistent with the ISO's stated objective of simplifying and clarifying the replacement/substitution rules. A focused effort to develop and implement a comprehensive overhaul of the replacement/substitution rules and process makes far more sense than piecemeal revisions implemented over the next three years. The broad framework for a unified and coordinated timeline for the replacement/substitution process outlined at pages 59-64 and Figure 15 of the Revised Straw Proposal appears promising, and there is no obvious reason why such a comprehensive reform of the replacement/substitution process cannot be fleshed out and in place in time for the 2016 RA Year. The Six Cities urge the ISO to move forward promptly to address in an integrated fashion all issues relating to the replacement/substitution rules and process.

The Six Cities request further explanation and/or clarification of the interrelationships among the AIM proposal and proposed revisions to the replacement/substitution rules. The discussion of the AIM at pages 22 and 39-40 indicates that planned outages for which the ISO does not require replacement and "resource outages . . . beyond the resource's control" will be excluded from the availability assessment. How does this correlate with the concept of providing substitute capacity for an RA resource subject to a forced outage, bearing in mind that under the ISO's recent revisions to the OMS tariff provisions, any outage that is requested less than nine days in advance (or seven days according to the ISO's idiosyncratic counting convention) is defined as a forced outage? Does the ISO contemplate a difference in treatment between an outage considered a forced outage simply because it is requested less than nine days prior to the commencement of the outage and a forced outage that is "beyond a resource's control?"

The Six Cities oppose elements of the Revised Straw Proposal that would place unnecessary restrictions on replacements/substitutions for unavailable RA resources. The fundamental goal of the ISO's replacement/substitution rules should be to maintain reliability by ensuring availability of capacity sufficient to meet forecasted needs while avoiding procurement of unnecessary, excess capacity. The replacement/substitution rules should reflect not only the operating characteristics of the RA resource affected by an outage (whether planned or forced) but also the duration of the outage. In general, replacement/substitution rules for RA resources should not impose eligibility requirements more stringent than necessary for the replacement/substitution period nor more onerous than the eligibility requirements for the capacity subject to replacement/substitution during that period. The replacement/substitution rules should allow the broadest possible array of resources to satisfy the replacement/substitution requirement consistent with maintaining reliability.

Applying these principles, the ISO's proposed terms for replacement of Flexible RA resources are unnecessarily restrictive. For an outage of limited duration, it is unreasonable to

require a replacement resource to satisfy all of the criteria for the category applicable to the resource to be replaced, as proposed at pages 48-49 of the Revised Straw Proposal. The ISO proposes that a Category 1 Flexible RA resource must be able to start up at least twice a day to be designated for a month. But if a designated Category 1 Flexible RA resource is subject to an outage (either planned or forced) for a week during a month, a use-limited resource with 15 allowed start-ups (as well as sufficient energy availability) should be eligible to serve as a replacement/substitute resource for the seven-day outage, as it will be able to meet the availability requirements for the resource on outage during the outage period. For similar reasons, the Six Cities also oppose: (1) the categorical prohibitions on allowing a use-limited resource to replace a non-use-limited resource or allowing a non-dispatchable resource to replace a dispatchable resource as recommended at page 46 of the Revised Straw Proposal, and (2) the proposal to require a "higher quality" resource providing substitute capacity to comply with the higher category must-offer requirements rather than the must-offer requirements applicable to the resource for which it is substituting (Revised Straw Proposal at 49).

Subject to the comprehensive approach to reform of the replacement/substitution rules as discussed above, the Six Cities specifically support the following proposed revisions to the replacement/substitution rules:

- Moving the deadline to provide Day-Ahead substitution from 6:00 a.m. to 8:00 a.m. (Revised Straw Proposal at 47);

- Prompt implementation of many-to-many substitution capability, including for Flexible RA resources (*Id.*);

- Expansion of substitution options for local RA resources (Revised Straw Proposal at 48);

- Release of capacity designated to provide replacement capacity if the outage that caused the replacement designation is moved (Revised Straw Proposal at 64);

- Allowing a system resource to substitute for a local resource that was designated only for system RA capacity (*Id.*).

To the extent the AIM applies to capacity subject to forced outage, the Six Cities reiterate their suggestion that the ISO allow real-time substitution for RA resources (both flexible and generic) with after-the-fact determination regarding the suitability of the substitute resource. Allowing real-time substitution for RA resources would encourage SCs to make resources capable of operating available to the ISO when designated RA resources are subject to forced outage. Although the Cities recognize that it may not be feasible for the ISO to pre-approve a substitution request submitted after the close of the Day-Ahead Market, it is not obvious why advance approval is essential either from the perspective of the ISO or from the perspective of the SC offering the substitute resource. If an SC makes available an alternative resource and requests that it be recognized as a substitute for RA capacity that is not available, and the ISO determines after-the-fact that the substitute resource was useful or could have been useful in meeting the ISO's needs, it would be reasonable to excuse the non-availability penalty otherwise applicable to the original resource. Alternatively, if the proposed substitute resource could not effectively meet the ISO's needs, then the non-availability penalty should apply. An SC offering a substitute resource in the Real-Time Market could not be assured in advance that the

substitution would be accepted, but there still would be an incentive to offer a substitute resource if there was a possibility of avoiding or mitigating a non-availability penalty.

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