

April 9, 2014

**COMMENTS ON BEHALF OF THE CITIES OF ANAHEIM, AZUSA, BANNING,  
COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA  
ON THE SECOND RELIABILITY SERVICES WORKING GROUP MEETING**

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 on the discussion at the second Reliability Services Working Group meeting on March 27, 2014:

**Defer for at Least Twenty-four Months Further Efforts at Development of a Residual or Backstop Capacity Auction and Request Permission to Extend the CPM as Necessary.**

Comments submitted to the ISO following the February 4, 2014 workshop on the Reliability Services Initiative ("RSI") overwhelmingly challenged the wisdom of devoting ISO and stakeholder resources to development of a residual and/or backstop capacity auction mechanism at this time. The same messages appeared in multiple sets of comments submitted by stakeholders having dramatically different market perspectives. Although there were some substantial differences in explanations, comments submitted on behalf of widely diverse stakeholder interests, including Load Serving Entities ("LSEs"), generators, marketers, and advocates for retail ratepayers, questioned whether it makes sense to pursue development of a residual or backstop capacity auction design in the near term. *See, e.g.*, the summaries in the ISO's comments/responses matrix of comments submitted by the Independent Energy Producers Association (matrix at 31), Northern California Power Agency (matrix at 34), NRG Energy (matrix at 43-44), Office of Ratepayer Advocates (matrix at 53, 56-57), Pacific Gas and Electric Company (matrix at 60-63, 65), and Western Power Trading Forum (matrix at 68-69), as well as the Six Cities' previous comments (summarized in the matrix at 66-67).

The development of a residual and/or backstop auction mechanism will involve difficult and divisive design questions. The presentation for the March 27<sup>th</sup> workshop alludes to some of these issues, including measures to address supplier market power (*e.g.*, establishment of a maximum offer price) or demand-side market power (*e.g.*, a minimum offer price). Although the ISO has attempted to estimate liquidity for a residual auction process (March 27<sup>th</sup> presentation at 55-60), the estimates appear to simply presume participation in the auction by LSEs for procurement of capacity differences between the annual and monthly RA showings and by suppliers for an equivalent or greater amount of capacity. If participation by either sellers or buyers is inadequate, price outcomes will be distorted. The potential for such price distortions will require the development of minimum participation standards as well as an alternative pricing mechanism (an administrative price?) if auction outcomes appear invalid. Moreover, the supply resources that participate in the auction may not yield a bid stack sufficient to satisfy the ISO's backstop needs as they occur. The potential need to backstop Local and Flexible RA requirements creates a real possibility that an auction-based resource stack will not include resources with the attributes required to satisfy the ISO's operational needs. Under those

circumstances, the ISO ultimately would have to resort to a CPM-like mechanism with an administrative price to meet the need, as recognized at page 18 of the comments/responses matrix.

The Six Cities again urge the ISO to postpone the commitment of ISO and stakeholder resources to the development of a residual and/or backstop auction mechanism. As several stakeholders commented on the Issue Paper, the existing RA framework has worked well for California. Generic capacity reserves are ample. LSEs have been diligent in satisfying RA requirements, and use of the CPM for backstop procurement by the ISO has occurred sparingly and primarily, if not exclusively, to meet unanticipated, “unsystematic” needs. While the Six Cities recognize that patterns of backstop procurement to date may not necessarily carry forward as system needs evolve, there is no justification for simply presuming that backstop procurement needs will become more systematic as opposed to remaining unsystematic. At this point, a residual or backstop capacity auction is a complex and very expensive solution in search of an unidentified problem.

As the Six Cities emphasized in their comments on the Issue Paper and on the February 4<sup>th</sup> workshop, the ISO plans to implement at least four major revisions to market structures and processes over the next eighteen months, *i.e.*, 15-Minute Scheduling, the Full Network Model Expansion, the Energy Imbalance Market, and Flexible Resource Adequacy requirements. Until there is practical experience with how these substantial changes in market design will affect both RA requirements and the operational availability of RA resources, an effort to design a residual procurement auction mechanism may be unjustified from a cost/benefit perspective or, worse yet, counter-productive. The Six Cities again urge the ISO to request a two-year extension of the existing CPM provisions (including the annual percentage increase in the CPM price) until February 2018 and to defer consideration of a residual or backstop auction mechanism until approximately the first quarter of 2016, which should allow a full year’s experience with the market design changes to be implemented later this year and in early 2015. It makes no sense to force a substantial commitment of limited resources - - both the ISO’s and stakeholders’ - - to pursue development of an auction mechanism that is not needed to maintain reliability and does not have substantial stakeholder support.

**Develop or Adapt Energy and Ancillary Services Products and RA Replacement/Substitution Rules to Maximize Availability and Use of Existing and Anticipated Capacity Resources.**

The limited application of the CPM to date to address episodic and unsystematic capacity needs confirms that the existing RA framework effectively satisfies needs for System and Local RA resources. Because Flexible RA requirements are not yet in place, there is no direct market experience on which to draw. The information at page 26 of the ISO’s presentation for the February 4<sup>th</sup> workshop, however, indicates that the existing RA resource fleet contains approximately 25,000 MW of flexible capacity that has been operationally available to the ISO through economic bids and more than 20,000 MW of additional RA capacity with flexible attributes that could be made operationally available to the ISO. Measures to encourage economic bidding by RA resources (as well as non-RA resources) appear to offer access to low-hanging fruit and ought to be the focus of near-term efforts by the ISO and stakeholders.

Although the ISO's proposed Must-Offer requirements will compel economic bidding by resources capable of meeting the Category 1 eligibility requirements and designated as Category 1 Flexible RA resources, there are additional resources with flexible attributes that will not be able to satisfy the demanding Category 1 criteria and, therefore, will not be subject to the associated Must-Offer requirements. The ISO should seek to identify and develop measures that will encourage System and Local RA and non-RA resources with flexible attributes to participate through economic bidding on a spot market or shorter-term basis. One such measure is the Flexible Capacity Product, which the Cities urge the ISO to develop promptly and to craft in a way to invite participation by as broad an array of resources as possible.

In addition, replacement and substitution rules for RA resources should not impose eligibility requirements more stringent than necessary for the replacement or substitution period or more onerous than the eligibility requirements for the capacity subject to replacement or substitution. The ISO's responses at pages 10 and 68 of the comments/responses matrix indicate that the ISO is re-considering a current practice (which does not seem to be reflected in the tariff) of requiring a resource that replaces or substitutes for a local resource designated for System RA capacity to satisfy Local capacity requirements as well. This practice unjustifiably expands Local RA obligations, and the Six Cities support a rule that allows replacement or substitution with like-for-like capacity (although "higher" quality capacity obviously should be eligible to replace or substitute for "lower" quality capacity if desired by the Scheduling Coordinator having the obligation to replace or substitute).

With regard to implementation of Flexible RA requirements, 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 substitute or replacement resource for the seven-day outage. In general, the ISO should craft replacement and substitution rules to allow the broadest possible array of resources to satisfy the replacement/substitution requirement consistent with maintaining reliability.

### **Increased Standardization Is Not Desirable at This Time.**

The ISO's comments/responses matrix makes clear (*e.g.*, at pages 22 and 30) that the impetus for increased standardization of capacity products is to facilitate optimization of procurement through an auction process. For all of the reasons described above, the Six Cities oppose the development of a residual or backstop auction process until there is greater clarity regarding the nature and scope of the ISO's backstop needs. For similar reasons, it is unjustified and potentially counter-productive to devote efforts to increasing standardization of capacity products at this time. The unsystematic residual capacity needs that are likely to arise on occasion may involve attributes that are specific to the situation and, hence, may not be resolved by procurement of a standardized capacity product. In addition, as discussed under the second topic above, short-term replacement or substitution resources should not be required to have all the attributes of the RA resources for which they are standing in - - only those required for the period of replacement/substitution. Increased standardization may impede cost-effective use of

available capacity resources to meet non-standardized or short-term needs, which may end up being the only backstop needs that occur.

**Cost Allocation for Backstop Procurement Should Track Cost Causation.**

Whatever backstop procurement mechanism the ISO considers, allocation of the associated costs should be based strictly on cost causation principles. If resource performance characteristics lead to backstop procurement costs, the relevant resources should bear the associated costs, whether the resources in question are preferred or traditional in nature. To promote both transparency of market processes and fundamental fairness, the ISO should avoid socialization of backstop procurement costs to the maximum extent possible.

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