

Opening Comments of Keith Casey (California ISO)

Discussion Panel on Resource Adequacy and Market Power Mitigation

FERC Technical Conference, November 6, 2003

This panel is addressing the very critical question of whether the new California market structure, as defined by the CAISO's proposed market design and the eventual CPUC resource planning and procurement rules for the investor owned utilities, will produce an efficient, stable, and sustainable market environment.

I would like to offer some initial comments on what the ISO sees as the critical elements of a resource adequacy plan and how such a plan relates to the ISO MD02 design.

The ISO believes that a resource adequacy requirement for load serving entities is a critical component of the overall wholesale market design. A resource adequacy requirement is needed to:

1. Provide, in the long-term, a platform for future investment in California's electric infrastructure and maintaining adequate revenues for needed existing generation;
2. Support in the shorter-term, reliable system operations; and
3. Mitigate the amount and effect of market power by encouraging utilities to enter into long-term contracts.

The ISO has been an active participant in the CPUC Procurement Proceeding and in testimony and during the hearings, we have laid out several features of an effective resource adequacy requirement:

1. A well defined requirement that the utilities procure on a forward basis, sufficient resources to meet their projected peak load plus adequate planning reserves, with reasonable limitations on reliance on short-term and spot market purchases coupled with fair and ex ante cost-recover rules;
2. Consistent definitions and counting conventions of what constitutes eligible capacity;
3. A process to review utility procurement plans with particular emphasis on deliverability and transmission planning, and an annual process to update these plans to ensure they are on track.
4. An explicit obligation to procure at least one month ahead of time, adequate capacity to meet 100% of projected peak load plus planning reserve;
5. A process to make the resources procured by the utilities known and available to the ISO for commitment and use, if needed, in the day-ahead, hour-ahead, and real time markets; and
6. Well defined consequences for failure by the utilities to meet their resource adequacy obligations.

The ISO is particularly concerned that the value of a resource adequacy requirement will not be fully realized unless there is a coordinated "hand-off" of the resources procured by

the utilities to the ISO and is concerned that to date most parties have given short shrift to this important issue. Absent such coordination, the ISO is concerned that;

1. There may be operation problems if the ISO does not have accurate information about the resources that have been procured by the LSEs to serve their load.
2. Supply short-fall problems if the ISO does not have an ability to commit resources that have been procured by the utilities in the day ahead and real time frames as necessary to meet their projected load.

Fundamentally, the ISO needs to know which resources are obligated to serve the utilities' load in real-time. The value of a resource adequacy will not be realized unless the ISO can optimally utilize the resources committed to serving the utilities' load.

Once the core elements of a resource adequacy program are established, including an obligation to make information and resources available to the CAISO, the ISO, state agencies and utilities can work to determine the precise details of the information exchange and coordination with the ISO. If a result of this work is a consensus view that certain elements should be addressed in the ISO tariff, the ISO is willing to modify its tariff and aspects of the MD02 design to conform with the state's requirements.

In summary, the ISO believes a resource adequacy program along the lines defined above will

- Create a structure that supports long-term infrastructure investment.
- Result in appropriate signals for load and generation to forward contract.
- Provide an appropriate mechanism for financing new power plants and retaining existing merchant generation – to the extent such generation is economically viable and critical for meeting demand.

The ISO is also very concerned about an alternative joint recommendation for a phased approach to resource adequacy that is proposed by the three IOUs and supported by the CEC. The ISO believes this proposal is deficient in the following respects:

- Places too much reliance on the spot market.
- Lacks a monthly requirement to demonstrate sufficient capacity has been procured to meet 100% of forecasted peak demand plus planning reserves.
- Provides for too low of a planning reserve margin and too long of phase in period.

With respect to the relationship between resource adequacy and the ISO market design elements, such as market power mitigation, the ISO offers the following comments.

- The MD02 market design guarantees operating cost recovery for units committed in the day-ahead market and the residual unit commitment process. The design provides for compensation of start-up, minimum load, and energy bid costs. Moreover, to the extent suppliers are infra-marginal, it also provides opportunities for them to earn additional revenues to contribute towards their going forward annual fixed costs.
- The MD02 market design was not and should not be designed to guarantee recovery of a unit's going forward annual fixed costs. As the FERC Commission itself has noted, the primary means of fixed cost recovery should be through long-term contracts.
- Similarly, the ISO believes that the primary driver for new generation entry is long-term contracts not the expected market revenues from the ISO spot markets.
- The ISO believes its proposed suite of market power mitigation measures strike the proper balance of providing adequate protection against market power under most system conditions and providing sufficient incentives for state agencies and load serving entities to take the necessary actions to ensure California has sufficient infrastructure to meet its current and future energy needs.
- The ISO understands that some suppliers that were not able to successfully negotiate long-term energy contracts during the energy crisis are now having difficulty recovering annual fixed costs on some of their facilities and are planning to moth ball certain facilities. The remedy for this unfortunate situation lies with the CPUC's resource adequacy plan. The remedy should not come from re-engineering the MD02 design to create new revenue sources for generators nor should it come from relaxing the proposed market power mitigation measures. Both approaches are likely to yield unintended and detrimental consequences to consumers. For instance, the ISO is particularly concerned about some of the detrimental market impacts that the FERC Commission's modifications to the RUC and Must Offer design is likely to have and looks forward to, at some point, discussing those concerns with the Commission.

In summary, the ISO MD02 design is intended to be a low volume, re-dispatch and optimization spot market for congestion, energy, and ancillary services. The design guarantees operating cost recovery and provides some opportunities for additional market revenues that can contribute to recovering annual fixed costs. The MD02 design takes a firm approach to market power mitigation but the market power mitigation elements do not prevent suppliers from recovering their operating costs. The resource adequacy requirements being developed by the CPUC will provide the venue for long-term contracting, new generation entry, and ensuring generation critical for serving load receive adequate revenues to cover its going forward annual fixed costs.