

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Oversee the Resource Adequacy Program, Consider Program Refinements, and Establish Annual Local and Flexible Procurement Obligations for the 2019 and 2020 Compliance Years.

Rulemaking 17-09-020
(Filed September 28, 2017)

**COMMENTS OF POWEREX CORP.
ON ASSIGNED COMMISSIONER'S RULING SEEKING COMMENT ON
CLARIFICATION TO RESOURCE ADEQUACY IMPORT RULES**

POWEREX CORP.
Mike Benn, J.D., B.ASc.
Energy Trade Policy Analyst
Suite 1300 – 666 Burrard Street
Vancouver, BC V6C 2X8
Telephone: (604) 891-6074
Email: mike.benn@powerex.com

Vidhya Prabhakaran
Tahiya Sultan
Davis Wright Tremaine LLP
505 Montgomery Street, Suite 800
San Francisco, CA 94111-6533
Tel. (415) 276-6500
Fax. (415) 276-6599
Email: vidhyaprabhakaran@dwt.com
Email: tahiyasultan@dwt.com

Attorneys for Powerex Corp.

July 19, 2019

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Oversee the Resource Adequacy Program, Consider Program Refinements, and Establish Annual Local and Flexible Procurement Obligations for the 2019 and 2020 Compliance Years.

Rulemaking 17-09-020
(Filed September 28, 2017)

**COMMENTS OF POWEREX CORP.
ON ASSIGNED COMMISSIONER’S RULING SEEKING COMMENT ON
CLARIFICATION TO RESOURCE ADEQUACY IMPORT RULES**

Pursuant to the July 3, 2019, *Assigned Commissioner’s Ruling Seeking Comment on Clarification to Resource Adequacy Import Rules* (“Ruling”), Powerex Corp. (“Powerex”) offers these comments. The Ruling explains that some unspecified imports used by LSEs to meet Resource Adequacy requirements may not provide firm energy delivery to the grid when most needed.¹ The Commission should adopt measures ensuring that import Resource Adequacy contracts can be counted on to perform when called upon by the CAISO, eliminating the reliability risks associated with the current participation of speculative and non-firm import supply, while maximizing the participation of reliable internal and external supply to provide the greatest economic value for California ratepayers.

First, Resource Adequacy commitments should be backed by a forward commitment of real physical capacity. The Resource Adequacy rules should maximize the ability for real, physical, deliverable firm external supply to compete to supply capacity to California and support the objective of maintaining reliability at the least cost.

Second, capacity that is being relied upon should in fact be surplus to its expected obligations in the source Balancing Authority Area (“BAA”) where the capacity is located. The

¹ See Ruling at 4.

Commission should eliminate entities' abilities to sell Resource Adequacy that is not supported by actual surplus capability.

Third, all energy delivery commitments associated with Resource Adequacy contracts should be backed by sufficient operating reserves and firm transmission rights necessary to fulfill the supplier's delivery obligation with a high degree of confidence when dispatched by the CAISO.

To achieve these goals, the Commission should require suppliers to:

- 1) identify the source BAA and e-Tag source generation unit (or physical system) at the time of System Resource Adequacy showings;
- 2) submit an e-Tag identifying the same source BAA and generation source that was designated in the contract during each and every hour of the delivery period, including firm transmission rights from source to sink;
- 3) include contract language affirming that *at the time that the supplier enters the commitment* it has a reasonable expectation that the capacity supporting the contract will not to be needed to meet any other capacity obligations in the source balancing authority area; and,
- 4) include contract language confirming that it will carry sufficient operating reserves—including sufficient spinning, non-spinning and balancing reserves—and procure sufficient firm transmission rights necessary to ensure that the resource can deliver energy in accordance with any associated energy delivery commitments.

I. THE RESOURCE ADEQUACY IMPORT RULES ARE PROBLEMATIC AND THREATEN CALIFORNIA'S RELIABILITY NEEDS

The goal of the Resource Adequacy program is to procure sufficient capacity on a forward basis to maintain reliability within California with the least cost to California consumers. The existing rules governing the participation of imports in the Resource Adequacy program do not ensure that all import Resource Adequacy contracts represent firm commitments to meet California's reliability needs backed by the real physical capability (*i.e.*, "steel in the ground") and firm transmission rights necessary to meet associated delivery obligations. Specifically, the

existing import Resource Adequacy rules currently present a number of problems:

1. entities may enter into Resource Adequacy commitments that are not backed by the forward commitment of real physical capacity;
2. some of the capacity that is relied upon is not surplus capacity; and,
3. the supplier can fail to procure sufficient operating reserves and firm transmission to fulfill associated energy delivery obligations.

As a result, the current Resource Adequacy rules harm California ratepayers, harm suppliers who compete to provide real physical capacity with their firm commitments, and threaten reliability in California.

A. Entities May Enter Into Resource Adequacy Commitments Not Backed by the Forward Commitment of Real Physical Capacity

The existing requirements create opportunities for entities to enter into Resource Adequacy commitments not backed by a forward commitment of real physical capacity. California ratepayers bear significant costs for commitments that make little contribution to meeting system reliability needs. Because a supplier is not required to make any commitment that it actually has the surplus physical capacity to support its obligation at the time the Resource Adequacy contract is executed, an external entity can enter into a Resource Adequacy contract with an LSE and either: (1) submit a relatively high priced offer into the day-ahead market to minimize the chances it will have to deliver energy; or (2) submit an offer more likely to be dispatched, hoping it can procure energy on a short-term basis to fulfill any dispatched energy obligation. But even if such entities can and do often procure energy through the short-term markets, such commitments represent little more than “paper capacity,” provide no resource adequacy value to California LSEs, are no different than simply lowering the Resource Adequacy requirement in the first place, and enable these entities to avoid the costs associated with providing real physical capacity to California.

Resource Adequacy commitments should represent a forward commitment of real physical capacity, not a promise by an energy market intermediary to procure energy in the short-term markets if energy is called upon to meet its delivery obligations. Such arrangements allow certain entities to be compensated as if they are committing capacity to California when they are not.

B. The Capacity Relied Upon is Not Surplus

Under existing rules, an external supplier may have a physical capacity quantity equal to or greater than its import Resource Adequacy contract. However, some or all of that capacity is not surplus to its expected obligations in the source BAA where the capacity is located. In this situation, the same physical capacity is being counted upon to maintain reliability in both the source BAA and California. These contracts raise the same risks and concerns as in the scenario where the external seller doesn't have any physical capacity at all. Here, the contract is only notionally backed by physical capacity, but the supplier is effectively depending on its ability to procure firm energy in the short-term markets, including in peak demand hours, to meet its commitment to the home BAA. If it's unsuccessful, it will curtail its deliveries to California. California ratepayers are effectively paying the supplier for a product the supplier is not actually providing—the forward commitment of physical capacity to California.

C. The Supplier Can Fail to Procure Sufficient Operating Reserves and Firm Transmission to Fulfill Energy Delivery Obligations

Under the existing program, the contract may be backed by physical capacity, but the supplier has failed to procure sufficient operating reserves necessary to fulfill the supplier's delivery obligation with a high degree of confidence; and/or deliveries are supported by non-firm transmission. To the extent that the supplier fails to carry sufficient operating reserves (including spinning, non-spinning, and balancing reserves) to support its commitment, it may

curtail deliveries to the CAISO when there is either an outage or renewable production slows. Similarly, where a contract is supported by non-firm transmission, deliveries to California will be curtailed if firm rights holders over the transmission path use their rights. This can often happen when the firm rights holder uses its rights to deliver energy to other BAAs. Again, California ratepayers are being required to bear the costs of capacity that may not be available to meet system needs when called upon by the CAISO.

D. Contracts Based on Speculative, Non-Firm Supply Harm California Ratepayers

Allowing import Resource Adequacy contracts to continue to count towards meeting Resource Adequacy requirements in any of the scenarios above is inconsistent with the objectives of the Resource Adequacy program and allows certain entities to receive “money for nothing” to the detriment of California ratepayers. California ratepayers are harmed because they bear significant costs associated with these contracts—which represent little more than “paper capacity”—without actually receiving the reliability benefits associated with the forward procurement of capacity. When a portion of these entities inevitably fails to deliver energy in the short-term markets in accordance with their commitments, often in higher demand hours, California ratepayers are then required to bear the costs of short-term energy prices that are higher than would have otherwise occurred if real physical capacity was committed on a forward basis to California.

E. Contracts Based on Speculative, Non-Firm Supply Harm Physical Suppliers

Physical suppliers that have invested in physical capacity, operating reserves, and firm transmission rights – and who could play an expanded role in cost-effectively meeting California’s reliability needs – are “crowded out” of the market because of speculative suppliers. Because an external supplier that supports its commitment with real, surplus, physical capacity

and necessary investments in transmission rights will incur numerous costs that a speculative supplier, as described above, is able to avoid, speculative suppliers displace physical supply from the market by undercutting the pricing of those internal resources and external suppliers that have the capabilities to actually perform.

F. Contracts Based on Speculative, Non-Firm Supply Threaten Reliability in California

The historical ability of speculative and non-firm suppliers to procure energy through the short-term markets provides no comfort about future performance given tightening grid conditions throughout the West. At the same time that California is experiencing growing capacity and flexibility challenges, other states and provinces throughout the West are experiencing similar challenges as they seek to retire their fossil-fueled generation fleet and increasingly rely on renewable resources to meet their needs. As grid conditions tighten and regions outside of California increasingly enter into forward commitments to secure the limited surplus capacity and flexibility that exists, the quantity of energy available on a short-term basis to backstop import Resource Adequacy contracts may be far more limited than in the past. Absent steps by the Commission, the likely result will be an increase in the non-delivery of import Resource Adequacy and higher reliability risks for California ratepayers, particularly during periods of stressed conditions across the West.

Historical information regarding the frequency of delivery failures on import Resource Adequacy contracts is likely to significantly understate the portion of Resource Adequacy requirements being met by speculative or non-firm supply or the reliability risks associated with this supply. The fact that a certain percentage of import Resource Adequacy failed to deliver during a given period does not mean that the remaining import Resource Adequacy contracts were backed by physical capability committed on a forward basis and firm transmission to

ensure delivery. A material portion of the remaining import Resource Adequacy contracts may have also been speculative – these non-firm suppliers may have either bid their associated energy supply into the market at a level that would ensure that they would not clear or were fortunately able to procure sufficient energy through the short-term markets to deliver on their energy dispatches.

A significant portion of speculative and non-firm suppliers may procure short-term energy to fulfill their delivery commitments in the vast majority of hours when there is low to moderate load in the West and supply is less constrained. But the point of a Resource Adequacy program, by design, is to ensure that there is sufficient capacity available during critical hours of peak load and/or regional supply scarcity to reliably operate the system and serve demand with a high degree of confidence. These hours present the most likelihood that there will not be sufficient energy available through the short-term markets to backfill these Resource Adequacy commitments and when it is most critical that there be physical capacity, operating reserves, and firm transmission rights that have been set aside to meet the needs of California. The available information suggests that a significant portion of import Resource Adequacy contracts may be made up of speculative or non-firm supply, as a significant portion of the supply associated with import Resource Adequacy contracts is being bid into the market at levels that ensure that they are not required to deliver, even during the tightest grid conditions,² and import delivery failures typically skyrocket during peak periods.³

² CAISO, Dept. of Market Monitoring, *Import Resource Adequacy* at 3 (Sept. 10, 2018) (stating that on July 24, 2018, “only 84 percent [of Resource Adequacy import capacity] was accepted in the day-ahead market in hour-ending 20 with a system marginal energy price of \$979/MWh”), available at: <http://www.caiso.com/Documents/ImportResourceAdequacySpecialReport-Sept102018.pdf>.

³ CAISO, Intertie Deviation Settlement, Draft Final Proposal at 34-37 (Feb. 13, 2019), available at: <http://www.caiso.com/Documents/DraftFinalProposal-IntertieDeviationSettlement-UpdatedFeb13-2019.pdf>.

The Commission recently acknowledged that it could require as much as 8,800 MW of import Resource Adequacy contracts to meet system peak by 2021.⁴ Unless the Commission modifies the rules governing import Resource Adequacy contracts, it may find that a significant portion of the imports used to meet these requirements are not backed by physical capability and firm transmission rights that will meet California’s reliability needs. In fact, as grid conditions tighten, the portion of import Resource Adequacy contracts made up of speculative and non-firm supply may increase over current levels, as higher Resource Adequacy prices increase the financial incentive for entities to sell Resource Adequacy that they simply do not have.

II. MODIFYING THE RESOURCE ADEQUACY IMPORT RULES WILL ENSURE THE MOST ECONOMIC VALUE AND RELIABILITY FOR CALIFORNIA RATEPAYERS

California ratepayers should not bear the economic costs and reliability risks associated with speculative and non-firm supply. That said, it would not be efficient to require that suppliers that commit to provide import Resource Adequacy deliver energy in each hour of the delivery term. Instead, the Commission, working closely with the CAISO, should take steps to verify that LSEs meet their Resource Adequacy requirements with contracts backed by real physical capacity and all dispatched energy is delivered with sufficient operating reserves and on firm transmission rights to ensure delivery with a high degree of confidence. To achieve this goal, the Commission could require the supplier to:

- 1) identify the source BAA and e-Tag source generation unit (or physical system) at the time of System Resource Adequacy showings;
- 2) submit an e-Tag identifying the same source BAA and generation source that was designated in the contract during each and every hour of the delivery period, including firm transmission rights from source to sink;

⁴ *Assigned Commissioner and Administrative Law Judge’s Ruling Initiating Procurement Track and Seeking Comment on Potential Reliability Issues*, Rulemaking 16-02-007, at 12 (June 20, 2019).

- 3) include contract language affirming that *at the time that the supplier enters the commitment* it has a reasonable expectation that the capacity supporting the contract will not to be needed to meet any other capacity obligations in the source balancing authority area; and,
- 4) include contract language confirming that it will carry sufficient operating reserves—including sufficient spinning, non-spinning and balancing reserves—and procure sufficient firm transmission rights necessary to ensure that the resource can deliver energy in accordance with any associated energy delivery commitments.

Adopting requirements that are unnecessarily stringent or that erect barriers to entry to real physical suppliers with the capabilities to deliver firm energy to California will only serve to needlessly increase Resource Adequacy costs by preventing California’s reliability needs from being met using the most efficient and cost-effective mix of resources possible. But maintaining the existing gaps in requirements to persist that allow entities to enter Resource Adequacy commitments when they do not have the capability and/or intent of performing will continue to result in California ratepayers bearing the costs of contracts that provide little value in preserving the reliability of the California grid.

There will be both energy market intermediaries and some California LSEs who have a vested interest in a continuation of the status quo and are likely to oppose adopting such requirements. First, certain external sellers will have a financial incentive in continuing to sell “paper capacity,” allowing them to reap the financial benefits of a Resource Adequacy contract without incurring the costs in investing in the physical capabilities and transmission rights necessary to support their obligation. Second, certain LSEs that are currently contracting with these entities may also have a financial interest in continuing to meet Resource Adequacy requirements with “paper capacity,” as these contracts may be less expensive than contracts backed by the actual forward commitment of physical capacity. This reflects that in an

integrated grid the reliability risks of one LSE's forward procurement decisions are socialized over all users of the grid.

While 100% of the cost savings associated with relying on paper capacity will flow to the entity selling the paper capacity and the individual LSE purchasing the paper capacity, the reliability risks associated with such contracts will be spread across all LSEs across the entire CAISO grid and to all California ratepayers. Accordingly, the Commission should adopt these additional requirements to reduce these reliability risks and the overall harm to California ratepayers.

III. RESPONSES TO THE SPECIFIC QUESTIONS IN THE RULING

1. Should Commission decisions (a) require RA import contracts to include the actual delivery of firm energy with firm transmission and (b) clarify that only a bidding obligation is deemed not sufficient to meet RA rules?

It would be highly inefficient to require that all import Resource Adequacy contracts deliver energy for all hours, or any subset of hours, during the delivery term without regard to whether the energy is economically efficient. Such an approach will exacerbate oversupply and flexibility challenges in the CAISO's short-term markets while also raising the costs of import Resource Adequacy contracts, as suppliers will need to factor in the potential economic losses associated with energy deliveries that are uneconomic.

There are two types of import Resource Adequacy contracts: (1) firm energy contracts, which require the LSE to accept energy delivery each contracted hour of each day of the contract term, typically resulting in self-schedules by the LSE into the CAISO's day-ahead market; and (2) Resource Adequacy capacity commitments, which result in the seller accepting a standalone obligation to bid the capacity into the CAISO markets on a daily basis according to CAISO's must-offer rules for System Resource Adequacy imports. Both types of contracts, provided they are supported by real surplus physical capacity on a forward basis and any associated energy

deliveries include sufficient operating reserves and firm transmission rights, can play a cost-effective role in continuing to meet California's reliability needs.

However, it is important that the rules relating to import Resource Adequacy contracts continue to enable CAISO to optimize the scheduling and dispatch of resources through its short-term markets to ensure that system requirements are met using the most-efficient and cost-effective resources, including import resources associated with a Resource Adequacy commitment and import resources that voluntarily make themselves available through CAISO's day-ahead and real-time markets. Imposing a requirement that suppliers with import Resource Adequacy commitments deliver energy during each hour of a given month, season, or year goes far beyond the requirements imposed on internal resources and will greatly interfere with CAISO's dispatch and scheduling processes, resulting in the inefficient dispatch and depletion of external resources to the detriment of California ratepayers. It also has the potential to exacerbate California's flexibility and renewable integration challenges by encouraging entities with Resource Adequacy commitments to self-schedule deliveries of energy into California in hours in which this energy is unnecessary to meet system needs. Finally, such an approach will increase the costs of import Resource Adequacy contracts as suppliers will need to consider the potential for substantive economic losses associated with delivering energy in many hours that it may be uneconomic to do so.

At the same time, the Commission should not rely upon merely imposing an obligation on suppliers with an import Resource Adequacy contract to submit an offer into the CAISO markets to ensure that the resources committed to meet System Resource Adequacy requirements will deliver and actually provide value to California ratepayers. Instead, the requirements imposed on import Resource Adequacy requirements must be enhanced to ensure that all import

Resource Adequacy contracts will meet reliability needs by developing requirements and processes, in conjunction with the CAISO, that ensure that import Resource Adequacy contracts are backed by real, surplus physical capacity, and energy is delivered when called upon with sufficient operating reserves and firm transmission rights.

Merely requiring a supplier with an import Resource Adequacy contract to submit a day-ahead and/or real-time market offer provides no assurance that a contract has the physical capability and firm transmission rights necessary to deliver. Where a seller regularly complies with its must-offer obligation by submitting an offer at or near the bid cap, there is a risk that the seller may not have the surplus capacity, operating reserves and/or firm transmission rights necessary to fulfill its delivery obligations. Only imposing a requirement that a supplier submits a bid ensures that “resource adequacy imports could be routinely bid significantly above project prices in the day-ahead market to ensure that they do not clear and would then have no further obligation to be available in the real-time market.”⁵ Ultimately, such a rule creates a risk that LSEs will meet System Resource Adequacy requirements with “imports that may have limited availability and value during critical supply and market conditions.”⁶

2. Do parties agree that firm transmission capacity is required in addition to firm energy? Please explain why or why not.

The Commission should ensure that all import Resource Adequacy contracts are backed by firm transmission service during the delivery term. In particular, the Resource Adequacy program should require suppliers providing import Resource Adequacy to submit a day-ahead e-Tag for each hour of the delivery term of the contract that identifies firm transmission service from the generation source to the CAISO intertie scheduling point designated in the Resource

⁵ CAISO, Dept. of Market Monitoring, *Import Resource Adequacy* at 1-2 (Sept. 10, 2018).

⁶ *Id.* at 1.

Adequacy contract.

In evaluating the transmission that should be required to support a Resource Adequacy contract, the Commission should consider different priorities of transmission service that are available under the Open Access Transmission Tariff (“OATT”) framework that characterizes the West outside of California. Under this framework, the transmission capacity of a line may be sold multiple times to various rights holders, each of which have different priorities of use and access to the line. There are two broad categories of transmission service under the OATT:

1) *Primary service* – In the first instance, the capacity of a transmission path typically will be sold as firm transmission or, in some cases, conditional firm service. Firm rights holders (including conditional firm service) generally have priority access to the transmission capacity and are subject to curtailment only in certain limited circumstances, such as transmission de-rates.

2) *Secondary service* – Transmission capacity sold to firm rights holders is then resold on a non-firm basis to other transmission customers for periods that can vary from one hour to one year. The ability of a transmission customer to flow on its non-firm transmission rights generally depends on whether firm rights holders use their rights during a given period. If the available capacity of the line cannot accommodate schedules submitted by both firm and non-firm rights holders, then the schedules of non-firm rights holders will be curtailed as necessary to preserve the ability of firm rights holders to use the line.

Without a requirement that import Resource Adequacy contracts be supported by firm transmission, there is a risk that external transmission will be “double counted” for the Resource Adequacy program. Without such a requirement, multiple suppliers may rely on the very same transmission capacity to allow them to schedule energy to multiple BAAs, with the risk that

those holding non-firm rights will have their schedules curtailed to the CAISO BAA to accommodate the schedules of firm rights holders. The lack of a firm transmission requirement increases the risk that a supplier that has committed to provide import Resource Adequacy will not be able to deliver when called upon by the CAISO. Importantly, the firm transmission holders may use their rights to deliver energy to another BAA, leaving the CAISO BAA short of the capacity associated with the resource adequacy commitment.

The risks associated with the lack of a firm transmission requirement have increased in recent years due to the implementation of intra-hourly scheduling. When the System Resource Adequacy program was first implemented, non-firm rights holders generally were only subject to curtailment prior to each hour. With the implementation of intra-hour scheduling, however, firm rights holders can now submit schedules on an intra-hour basis, increasing the risk that they will interrupt non-firm transmission in a given hour. Thus, even if an import Resource Adequacy resource is supported by non-firm transmission at the beginning of a given hour, the implementation of intra-hour scheduling creates a risk that deliveries may nevertheless be curtailed on an intra-hour basis, when firm rights holders use their rights, including to deliver energy to other BAAs.

3. Should the Commission clarify its rules, or are existing decisions and requirements sufficient? If the former, please propose clarifying language and/or how such clarifications should be established.

Clarification of the rules governing the provision of import Resource Adequately is urgently needed. As the Commission recognized in the Ruling, the Commission previously has made clear that import Resource Adequacy contracts should be firm, backed by operating reserves, and supported by transmission that higher priority customers cannot interrupt. Nevertheless, there is growing evidence that the Commission cannot count on a portion of import

Resource Adequacy to deliver reliably when the CAISO calls upon it. This requires that the Commission, in coordination with the CAISO, take steps to clarify its existing policies and tighten the requirements imposed on import Resource Adequacy contracts to ensure that California ratepayers do not bear costs of Resource Adequacy contracts that may have limited availability and value in meeting California's reliability needs.

4. **If the Commission determines that RA import contracts with a bidding obligation, but without delivery of firm energy with firm transmission do not qualify as RA, how should these types of contracts be addressed going forward? Should these contracts be disallowed for the balance of 2019, beginning in 2020, or a later date?**

Any changes to the Resource Adequacy program made because of this proceeding should be implemented beginning in 2020. With 2019 more than halfway over, it would be inappropriate to disallow contracts entered into to meet Resource Adequacy requirements in 2019. As long as the Commission implements any changes and clarifications sufficiently before the deadline for the year-ahead showing for 2020 (*i.e.*, October 2019), there should be sufficient advance notice to market participants to apply these policies to the 2020 compliance year.

5. **How should LSEs document that their RA import resources meet the Commission's import rules? Examples may include, but are not limited to, LSEs providing attestations or certifications for each import contract or attestations from the import provider?**

The Commission should require that any LSEs that count import Resource Adequacy contracts towards meeting their Resource Adequacy requirements maintain copies of their contracts with suppliers and produce them to the Commission upon staff's request. Further measures should also be developed by CAISO, and integrated into its tariff, to supplement the Commission's efforts.

6. If necessary, how should Energy Division staff determine compliance?

Energy Division staff should verify compliance by auditing any import Resource Adequacy contracts that an LSE counts towards meeting its Resource Adequacy requirements. Permitting Energy Division staff to audit will minimize administrative burdens while providing transparency into compliance with Resource Adequacy requirements.

Critically, the CAISO Tariff must also ensure that import Resource Adequacy contracts represent firm commitments that will meet reliability needs. The CAISO Tariff should reflect requirements that energy dispatched or contracted for under import Resource Adequacy contracts be delivered on firm transmission and with sufficient operating reserves, and that suppliers demonstrate compliance through the submission of e-Tags as set out above.

7. If it is determined that the imports used by an LSE do not meet the Commission's firm energy requirements, does the existing RA penalty structure provide enough deterrence to prevent further transactions of this type? If not, what additional remedies or corrective measures should be imposed?

The existing Resource Adequacy penalty structure should be enhanced to increase the incentive for LSEs to meet their System Resource Adequacy requirements and avoid giving LSEs an “economic option” to fail to meet their Resource Adequacy requirements.

The current monthly penalty creates an economic incentive for California LSEs to under-procure the capacity necessary to meet System Resource Adequacy requirements in the one or two highest peak demand months. The Commission penalty of \$6.66/kW month – if applied only to one or a few months – is likely to be significantly below the costs associated with building capacity. The incentive for under-procuring could be reduced by implementing an annual penalty structure under which an LSE would be subject to penalties for its maximum quantity failure in any month to meet their System Resource Adequacy requirements. The Southwest Power Pool (“SPP”) applies this approach. The incentive to under-procure could also

be reduced by increasing the penalties applied under the CAISO Tariff for failing to procure sufficiency System Resource Adequacy. Under the CAISO Tariff, an LSE that fails to meet its System Resource Adequacy requirements risks being allocated costs associated with procuring backstop capacity through CAISO Capacity Procurement Mechanism (“CPM”).

The compensation given to a resource procured through the CPM, however, is limited by the CPM Soft Offer Cap (equal to \$6.31/kW-month or \$75.68/kW-year). Currently, the CPM soft offer cap is based on the annualized cost of a new entrant, *but pro-rated over 12 months*. Importantly, this cap applies to a 1-month contract, even if the seller of the capacity receives no contract or capacity compensation in the remaining 11 months of the year. The effect is to limit the compensation provided to the resource to approximately 1/12 of the going forward costs of a new resource. Again, given the level of the current soft offer cap, it may be economic for an LSE to under-procure in certain months and bear the risks associated with an allocation of CPM costs rather than procuring capacity.

To strengthen the incentives for LSEs to procure capacity that meets the requirements established by the CAISO and the Commission, the CPM mechanism should be modified to implement an annual penalty that is applied based on the magnitude of the maximum shortage in any month. The backstop procurement mechanism currently employed by SPP provides an example of a mechanism that California could implement to promote robust forward procurement by LSEs. Notably, in SPP, LSEs must meet seasonal peak (not monthly peak) resource adequacy requirements and failure to do so results in the assessment of an annual deficiency payment that increases with the magnitude of system shortages. More specifically, in SPP, a deficiency triggers the application of a penalty equal to annual cost of new entry (“CONE”), currently set at \$85.61/kw-yr, multiplied by a penalty factor that ranges between

125% and 200%.⁷ This currently results in a price of approximately \$107/kw-yr to \$171/kw-yr for each MW of failure in the summer season.

Respectfully submitted,

/s/

Vidhya Prabhakaran

Tahiya Sultan

Davis Wright Tremaine LLP

505 Montgomery Street, Suite 800

San Francisco, CA 94111-6533

Tel. (415) 276-6500

Fax. (415) 276-6599

Email: vidhyaprabhakaran@dwt.com

Email: tahiyasultan@dwt.com

July 19, 2019

Attorneys for Powerex Corp.

⁷ See SPP OATT, Attachment AA, Section 14.2, available at: <https://www.spp.org/documents/58597/attachment%20aa.pdf>.