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

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|---|---|
| Order Instituting Rulemaking to Oversee the Resource Adequacy Program, Consider Program Refinements, and Establish Forward Resource Adequacy Procurement Obligations. | Rulemaking 19-11-009<br>(Filed November 7, 2019) |

# COMMENTS OF POWEREX CORP. ON TRACK 1 IMPORT RESOURCE ADEQUACY PROPOSALS

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Pursuant to the January 22 *Assigned Commissioner's Scoping Memo and Ruling,* ("Scoping Ruling") Powerex Corp. ("Powerex") respectfully submits to the California Public Utilities Commission ("Commission") these comments on the Track 1 resource adequacy ("RA") proposals filed on February 28.

## I. THE COMMISSION SHOULD REQUIRE ALL CONTRACTS UNDER THE RA PROGRAM TO COMMIT REAL PHYSICAL CAPACITY AS PROPOSED BY THE CAISO AND POWEREX

For the CAISO to reliably operate the CAISO grid, it must have access to the forward commitment of real physical resources. This necessitates that the Commission require that all contracts used to meet California RA obligations be backed by real physical capacity to ensure that RA supply is capable of "showing up" when it matters most. Designing these requirements so it is workable for the largest possible number of reliable suppliers of real physical capacity ensures both competitive forward prices for these products and reasonable rates for California ratepayers.

Only the CAISO and Powerex have put forward specific, workable proposals that achieve these dual objectives. Both proposals are very similar. The Commission should adopt each of the specific elements put forth in the CAISO and Powerex proposals.

## II. THE COMMISSION SHOULD REJECT PROPOSALS THAT PERPETUATE "PAPER CAPACITY"

Other parties expressly propose to perpetuate existing loopholes that *permit* "paper capacity" contracts to continue to qualify as import RA, with proposals that continue to permit import RA contracts that fail to require the forward identification and commitment of any real physical capacity.[1] Under each such proposal, California load-serving entities ("LSEs") could continue to meet some portion of their RA obligations with forward firm energy contracts and/or stand-alone RA capacity contracts with marketers that can—and will—"go short" by relying on their ability to purchase energy in the external short-term bilateral markets to perform on their RA energy delivery obligations. The Commission should reject these proposals.

The CAISO has provided convincing, undisputed evidence of the substantial and increasing reliability risk California faces as a result of loopholes in the Commission's current import RA requirements.[2] Other evidence also establishes that grid conditions are rapidly tightening across the West—a fact now widely accepted throughout the industry.[3] The combination of these two factors means that a California LSE attempting to secure the forward commitment of real physical supply will face competition from LSEs <u>outside</u> of California.

Against this backdrop of tightening supply and rising forward prices for the commitment of real physical capacity, a marketer selling paper capacity can offer a California LSE an irresistible bargain: a way to nominally meet its RA obligation by exploiting a loophole that avoids the true cost of forward contracting for real physical capacity.[4] Importantly, LSEs

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[1] *See e.g.,* Southern California Edison Company and Shell Energy North America, Energy Division Staff and Morgan Stanley Capital Group Track 1 Proposals.

[2] *See* CAISO Track 1 Proposal at 1.

[3] *See* Powerex Track 1 Proposal at 1-2.

[4] Indeed, California LSEs may further benefit from paper capacity as such contracts can—and likely are—causing significant suppression of forward price for real physical supply in western markets. Paper capacity not only reduces California LSEs' purchases of forward physical supply, it also suppresses the competitive market price for any forward physical contracts they enter into.

purchasing such paper capacity contracts are neither responsible for the reliability risk nor for securing alternative supply at the last minute when energy deliveries associated with paper capacity contracts fail to show up; those responsibilities fall upon the CAISO.[5] It is therefore not surprising that some California LSEs wish to avoid the cost of contracting for real physical supply, or that certain marketers seek to continue to collect tens of millions of dollars per year from California ratepayers by selling "cheap" paper capacity *that will do nothing to keep the lights on*.

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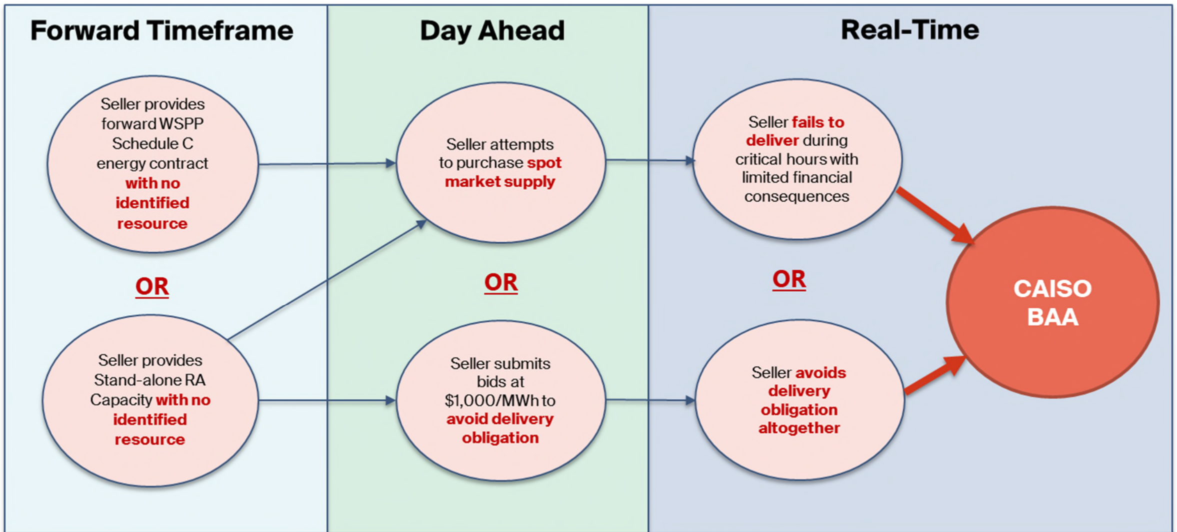
[5] *See* Powerex Track 1 Proposal at 4-5.




| HARMFUL CONSEQUENCES | |
|---|---|
| **Forward Timeframe** | **Operational Timeframe (Day-Ahead and Real-Time)** |
| **Leaves CAISO short** of sufficient forward committed capacity needed to reliably meet load | Creates **significant reliability risk** for CAISO BAA |
| **Prevents real suppliers** from receiving RA contracts | **Forces CAISO BAA to lean** on short-term markets to make up for RA shortfalls (*i.e.*, intertie bids and EIM) |
| **Artificially suppresses import RA prices**, distorting forward wholesale electricity markets | Increase in short-term **energy price spikes** in CAISO BAA and across EIM Area |
| **Undermines CAISO's ability to join** and **participate** in a regional day-ahead organized market | **Severely limits CAISO's ability to pass** an accurate EDAM and/or EIM Resource Sufficiency test |
| **Disadvantages in-state renewables** relative to external renewables | |

Both the CAISO and Powerex proposals reject this "loophole" approach. A handful of California LSEs and marketers differ. But the reason that paper capacity is so irresistible to California LSEs and marketers is the same reason the Commission must eliminate it from the RA program: cheap paper capacity contracts represent a naked bet that there will be enough energy available to be purchased in the short-term bilateral market when California consumers need it. And each time the Commission permits LSEs and marketers to enter into such contracts, real physical capacity is *prevented* from being committed in advance to allow the CAISO to reliably serve California electricity consumers. The Commission must reject proposals that allow the use of paper capacity to continue.

## III. THE COMMISSION FACES A CRITICAL CHOICE: PROTECT RELIABILITY OR CONTINUE TO TOLERATE PAPER CAPACITY IN THE RA PROGRAM

In light of all that has become known about paper capacity contracts and the consequences of going "short" on real physical supply commitments, any proposal that does not *require* the identification and commitment of real physical capacity *permits and condones* an unnecessary high-stakes gamble on the availability of energy in the short-term bilateral markets. There is no longer any plausible deniability that this is the case. The current paper capacity problem in the RA program is well understood and solutions are readily available. The Commission should implement the specific solutions proposed by the CAISO and Powerex *before* the grid experiences reliability events and corresponding price spikes.

The Commission's determination therefore represents an affirmative choice between safeguarding California's RA program to ensure the reliability of the California grid or permitting the continued use of low-cost paper capacity contracts that provide the *illusion* of resource adequacy but make California consumers vulnerable to costly and dangerous reliability events when paper capacity fails to show up in critical hours of need. The Commission must adopt the Track 1 proposal advocated by the CAISO (and/or the similar proposal put forward by Powerex) to safeguard the ongoing reliability of the grid, to protect California consumers, and to support the efficient functioning of forward and short-term wholesale electricity markets.

## IV. THE CAISO WILL LIKELY BE FORCED TO ACT TO PROTECT RELIABILITY IF THE COMMISSION FAILS TO DO SO

The CAISO has been unequivocal that paper capacity contracts materially and substantially undermine the RA program and put reliability at risk:

> *… self-scheduling or other firm energy delivery requirements do not address reliance on speculative supply. These approaches would continue to allow importers to sign contracts to provide resource adequacy imports without*

> *securing physical resources at the time or the showings, even if the Commission adopts a must-flow or self-scheduling requirement. This puts CAISO balancing authority area reliability at risk because resource adequacy import availability is subject to the residual energy availability in the short-term bilateral markets.*[6]

Given the *thousands of megawatts* participating in the RA program that represent supply that simply is not real, and the tightening grid conditions across the West, immediate action is necessary to avoid the reliability challenges and more frequent price spikes in the CAISO-operated markets that will likely be inevitable.

The CAISO has proposed specific measures to eliminate paper capacity from the RA program, helping restore the ability of the RA program to ensure grid reliability. If the Commission fails to adopt the specific measures proposed by the CAISO, however, the CAISO will be forced to consider taking further action on its own to protect reliability, including considering expanding its authority under its FERC-jurisdictional tariff to procure real physical capacity, perhaps on a year-ahead and season-ahead basis. Such unilateral actions, as determined necessary by the CAISO to protect reliability, would likely create material inefficiencies. For example, such actions could lead to redundant forward contracting efforts and expose California ratepayers to excess costs. Such actions could also disrupt the allocation of RA Import Capability as the same RA Import Capability may need to be claimed by both the CAISO for its forward commitments of real physical capacity and by California LSEs for their purchases of paper capacity contracts.

As costly and disruptive as such an outcome might be, the only alternative would be for the CAISO to fail to accept the clear and now well-documented reliability threat posed by paper capacity contracts. Action by the Commission to prohibit paper capacity contracts under the RA

[6] CAISO Proposal at 9 (emphasis added).

program is therefore essential to preventing the need for expanded unilateral measures by the CAISO to protect California's reliability.

## V. CALIFORNIA WILL FACE CHALLENGES TO PARTICIPATING IN EMERGING REGIONAL ORGANIZED MARKETS IF THE GAPS IN ITS RA PROGRAM PERSIST

There is unprecedented momentum and interest among entities in the West outside of California in developing and expanding organized electricity markets for the mutual benefit of all participants and regions, including California. A western day-ahead organized market could realize significant savings for all consumers through hourly granularity of day-ahead transactions, lower-cost commitment and use of physical resources, and the diversification of variations and uncertainty in load and in renewable energy production.

However, multiple entities outside of California have made it clear that they will oppose any regional day-ahead market design that enables uncompensated "leaning" on the capacity and flexibility of resources funded by their ratepayers. The CAISO balancing authority area ("BAA"), largely due to the existing gaps in California's RA program, chronically lacks committed physical capacity to meet its peak net load in the summer and arguably also lacks sufficient flexibility to balance its system throughout each day. Without significant reforms, the CAISO BAA can thus expect to face significant challenges in demonstrating it is resource sufficient on a day-ahead basis and posing a barrier to its participation in a regional day-ahead organized market.

In addition, failure by the Commission to eliminate paper capacity from California's RA program in this proceeding is likely to affect the CAISO's existing markets — as entities in the region pursue stronger measures to prevent the current and extensive "leaning" by the CAISO BAA, which has increasingly come to light over the past year. This extensive leaning appears to occur through the CAISO's day-ahead and real-time intertie bidding framework, and there is now mounting evidence this also occurs in the real-time Western Energy Imbalance Market ("EIM").[7]

## VI. THE COMMISSION SHOULD REJECT PROPOSALS THAT ARTIFICIALLY SUPPRESS PRICES AND INTRUDE ON FERC-JURISDICTIONAL MARKETS WHILE DOING NOTHING TO ENSURE RELIABILITY

The proposals of Energy Division Staff ("ED Staff"), Morgan Stanley Capital Group ("MSCG") and the joint proposal by Shell Energy North America and Southern California Edison Company ("Shell/SCE") all perpetuate significant loopholes that continue to permit RA obligations to be met by forward contracts that do not require the advance identification and commitment of real physical resources. Specifically, as summarized below, these proposals continue to permit paper capacity contracts where either the marketer or the California LSE procures short-term energy and offers it as a price-taker (*i.e.*, as a self-schedule) or at newly-defined capped offer prices into the CAISO short term markets.

| Proposal | Price Controls |
|---|---|
| ED Staff Proposal | Require all RA to include a **CPUC-approved fixed energy price sale** to an LSE (except dynamically-scheduled or pseudo-tied resources) |
| | Force import RA energy to be offered as a price-taker in the CAISO's short-term energy markets (*i.e.*, **self-scheduled);** or possibly offered at -$150/MWh or $0/MWh |
| Shell/SCE Proposal | Apply an **energy offer cap** of $250/MWh in the CAISO's short-term energy markets (with increases tied to gas prices) |
| MSCG Proposal | Apply an **energy offer cap** of no less than $500/MWh in the CAISO's short-term energy markets |

The Commission should reject these proposals because they jeopardize reliability, artificially suppress prices, and impermissibly intrude on FERC-jurisdictional markets.

[7] Powerex has described in stakeholder comments, and provided underlying data, showing that the CAISO BAA was leaning on capacity from the Western EIM on September 3, 2019. *See* Comments of Powerex Corp. on Resource Adequacy Enhancements Third Revised Straw Proposal (January 27, 2020) at 10-14, included as Appendix A to Powerex's Track 1 Proposal.

*First*, merely imposing new energy offer price limits on marketers or LSEs (including "self-schedule" requirements) in the CAISO's short-term energy markets will do nothing to create the incentive for marketers to commit real physical supply on a forward basis.[8] Marketers will continue to have every incentive to "go short"—relying on their ability to acquire energy in the external short-term energy markets to meet their RA energy delivery obligations to the CAISO BAA and facing only nominal penalties when they are unable to do so.

*Second*, the proposals of ED Staff, MSCG and Shell/SCE effectively condone marketers and LSEs continuing to enter into paper capacity contracts that make the CAISO short-term energy market prices more likely to spike—and service to California consumers more likely to be interrupted—when California demand is high but tightening regional grid conditions make energy unavailable for purchase in the external short-term energy. The proposals simultaneously and inappropriately leverage the paper capacity contracts to artificially suppress CAISO market prices in all other hours (when the marketer *happens to find* energy in the external short-term energy markets and offers the energy to the CAISO at prices below these Commission-instituted offer price caps).

*Third*, the proposals of ED Staff, MSCG and Shell/SCE, if accepted, are also virtually certain to embroil the Commission in extensive legal challenges, because they seek to dictate the manner and price at which energy is offered in the CAISO markets. Not only would these requirements be challenged as having the unlawful effect of distorting markets subject to the exclusive jurisdiction and oversight of FERC, but they would also be challenged as an unlawful attempt to fix wholesale rates and make participation in the RA program contingent upon how a

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[8] Powerex OIR Comments at 2.

party participates in the CAISO's short-term energy markets.[9] If adopted, these proposals will likely be immediately challenged, both in the courts and at FERC.

For all the above reasons, the Commission should reject the proposals of the ED Staff, MSCG, and Shell/SCE.

## VII. REQUIRING FIRM TRANSMISSION DELIVERY IS BOTH WORKABLE AND VITAL FOR RELIABILITY

CAISO and Powerex propose to require all contracts under the RA program to require delivery on Firm transmission service. This requirement is critical to ensuring the deliverability of real physical supply committed to the CAISO grid. No party has presented any relevant evidence or credible argument against the need for a requirement to arrange delivery using Firm transmission, or against the workability of the specific proposals put forward by Powerex or CAISO. Accordingly, the Commission should adopt the proposed Firm transmission requirement.

### A. Delivery on Firm Transmission Is Necessary to Ensure CAISO Has Access to the Committed Physical Supply It Needs to Operate the Grid

Ensuring the *deliverability* of RA resources to California load is a critical component of the RA program. This deliverability requirement is applied in the RA program to internal resources in determining each resource's Net Qualifying Capacity (NQC), and is also the key driver for the very existence of the Local RA framework. This deliverability requirement is also applied in the RA program to external generation through the CAISO Import Capability ("CAISO IC") framework, which should ensure that all external RA resources are deliverable from the CAISO boundary into the CAISO BAA to serve California load.

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[9] *See Hughes v. Talen Energy Marketing*, 136 S. Ct. 1288, 1297-1299 (2016); *FERC v. Elec. Power Supply Ass'n*, 136 S. Ct. 760, 780 (2016); *Northern Natural Gas Co. v. State Corp. Comm'n of Kansas*, 372 U.S. 84 (1963).

Requiring external Firm transmission service—as opposed to Non-Firm transmission service or no transmission service at all—is similarly important to ensuring deliverability of external supply under the RA program. Firm transmission service (including Conditional Firm transmission service) is the only external transmission service available that “cannot be curtailed in operating hours for economic reasons or bumped by higher priority transmission.”[10] In contrast, deliverability is not ensured by Non-Firm transmission service, as it is subject to economic curtailment as a result of the use of higher priority Firm transmission service.

A requirement to arrange delivery over Firm transmission service for the delivery path *outside* the CAISO BAA is also comparable to the requirement that import RA contracts obtain a CAISO IC allocation for transmission *into* the CAISO BAA. The CAISO IC requirement appropriately ensures that RA contracts do not exceed the *CAISO* transmission available at a given intertie; requiring Firm transmission service similarly ensures that RA contracts do not exceed the capability of *external* transmission to deliver to the CAISO BAA. Indeed, it would be highly inconsistent for a party to support the requirement to obtain IC allocation for the CAISO side of delivering import RA contracts while not also supporting a comparable requirement for Firm transmission on all external paths.

CAISO and Powerex propose to require all contracts under the RA program to require delivery on Firm transmission service. Both Powerex’s and the CAISO’s proposals seek to make it workable for suppliers of deliverable physical supply to satisfy the requirement and participate in the RA program. Powerex has proposed that both Firm and Conditional Firm service be able to satisfy the transmission requirement; and Powerex has also proposed to allow the transmission requirement to be demonstrated as late as the Day Ahead timeframe. Going further and allowing import contracts to meet RA requirements where the marketer obtains no transmission service ,

10 D.05-10-042 at 67.

or obtains Non-Firm service on one or more segments of the delivery path, would be to abandon the deliverability principle altogether.

### B. MSCG's Opposition to a Firm Transmission Requirement Directly Conflicts With the Deliverability Requirements of the RA Program

Not surprisingly, some marketers would seek an RA program design that enables them to minimize or avoid any requirement to invest in external Firm transmission service. Predictably, marketers seeking to avoid such investments will claim that external Firm transmission service is unnecessary, or that requiring it presents an insurmountable challenge that only few suppliers could overcome. Such arguments are flatly incorrect.

In its proposal, MSCG argues that:

> *…the CAISO and Powerex advocated that suppliers must present a forward showing of firm transmission from source to sink in order to sell Import RA (the "Firm Transmission Requirement"). A Firm Transmission Requirement is unnecessary and will dramatically limit the number of market participants able to provide Import RA.*[11]

As an initial matter, MSCG misstates both Powerex's and the CAISO's proposals. Powerex did *not* propose to require that a supplier be required to show Firm transmission service reservations <u>at the time of the RA showing</u>.[12] Similarly, the CAISO's proposal states that "CAISO *prefers* the requirement for demonstration of firm transmission at the time of monthly showings[,]" but also that the Commission may consider requiring an "attestation that suppliers will deliver the energy from resource adequacy imports over firm transmission."[13] MSCG's comments thus oppose a requirement that no party has actually proposed.

MSCG appears to finally acknowledge that Firm transmission service reservations on key downstream transmission segments from the northwest to California (*i.e.*, John Day to COB or

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11 MSCG Proposal, at 8 (footnote omitted)

12 See Powerex presentation, *CPUC Input RA Workshop* at 12 (requiring at the time of the RA showing a contractual "[c]ommitment to arrange for delivery on firm transmission." (February 14, 2020).

13 CAISO Proposal at 5-6. (emphasis added)

Big Eddy to NOB) are held by a wide and diverse number of transmission customers. However, MSCG now advances claims regarding the upstream transmission segments that enable northwest generation resources to deliver energy to Big Eddy and John Day.[14] In support of its new argument, MSCG presents a table that purports to show that only a limited number of entities with Big Eddy to NOB service have also been able to acquire Firm service *to* Big Eddy.[15] MSCG's analysis and its arguments related to the ability of transmission customers to obtain Firm transmission service to Big Eddy are flawed and misleading on several counts:

- MSCG's table provides absolutely no evidence that additional Long-Term Firm transmission (including Long-Term Conditional Firm transmission) is unavailable to customers that seek to purchase it. Indeed, Bonneville Power Administration ("BPA") awarded several hundred megawatts of Long-Term Firm transmission service on the upstream segment to Big Eddy as recently as November 2019.

- In Powerex's experience, Firm transmission service is also frequently available for terms of less than one year on transmission paths to Big Eddy (and John Day), including not only new service sold directly by BPA (as the transmission provider) but also rights that are re-sold by Long-Term Firm transmission customers (through the northwest transmission resale market).

- Transmission customers with existing Firm transmission rights on other BPA transmission paths may redirect those rights on a Firm basis onto the BPA transmission paths that link northwest generation resources to Big Eddy (and John Day). Such redirects happen frequently, including on a monthly and daily basis.

- Forward capacity and firm energy products are also available for purchase directly *at* Big Eddy (and John Day), providing yet another option for marketers seeking to acquire real physical supply delivered on Firm transmission to support their participation in the RA program without requiring them to obtain transmission service to Big Eddy (or John Day).

MSCG's analysis shows that only a subset of the customers that have invested in Long-Term Firm transmission service to NOB have also chosen to purchase "upstream" Long-Term Firm transmission service to Big Eddy. MSCG's proposal does not—and cannot—make the case that Firm transmission service is unnecessary to ensure deliverability. Nor does its proposal

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[14] MSCG Proposal at 14.

[15] *See* MSCG Proposal at 11-12 and Table 2-A.

raise any credible argument against the CAISO and Powerex proposals to require all suppliers of RA-eligible contracts to commit to arrange for deliveries on Firm transmission service, and to later demonstrate compliance with this commitment through a Day Ahead e-Tag in all hours of the applicable RA contract.

The Commission should adopt the Firm transmission requirements proposed by Powerex, and work with the CAISO and stakeholders to ensure that implementation—both with respect to the commitments that must be made at the time of the RA showing and the actual Firm transmission service reservations that must be included in a Day Ahead e-Tag—enables maximum participation in the RA program of real physical supply that can be reliably delivered and supports efficient market outcomes in the CAISO day-ahead and real-time markets.

Respectfully submitted,

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