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 Procurement Obligations.	R.11-10-023

**OPENING COMMENTS OF
SHELL ENERGY NORTH
AMERICA (US), L.P.**

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In accordance with the procedural schedule adopted by the Presiding Administrative Law Judge, Shell Energy North America (US), L.P. ("Shell Energy") submits its opening comments on the Energy Division's ("ED") maximum cumulative capacity ("MCC") bucket proposal and the CAISO's flexible capacity proposal, both of which were addressed at the March 30, 2012 workshop.

I.

INTRODUCTION

The Commission should not adopt new RA procurement requirements for the 2013 RA compliance year. The ED proposal and the CAISO proposal seek to accomplish similar flexible resource procurement objectives. More discussion is required to address the details of each proposal, as well as the relative advantages and disadvantages of each approach.

The Commission should defer consideration of these proposals to "Phase 2" of this proceeding, during which time the parties should address the current and future need for these flexible procurement obligations, the specific resource characteristics that are sought, the classification of generation facilities in each resource category, and implementation details for the adopted approach (if any). The Commission should not embrace either one of these flexible procurement proposals before fully considering the market implications.

The underlying assumption of each proposal is that each LSE should be required to participate in a mandatory forward market for flexible RA capacity products. Imposing an additional RA procurement obligation on LSEs at this time, however, would impede the operation of the bilateral market. LSEs have relied on the bilateral market structure - - and the capacity requirements established through the adopted Standard Capacity Product - - to purchase capacity to meet their RA procurement obligations. The CAISO and ED proposals would add another layer of complexity - - and cost - - to LSEs' RA procurement obligations.

Mandating LSE procurement of RA capacity based on different, more "refined" operational characteristics would increase complexity for LSEs and increase costs for their customers without any demonstration that a reassessment of RA capacity characteristics is required. Bilateral procurement of reliability products to hedge a future load obligation is a more economically efficient means by which to acquire flexible resources. Imposing an additional RA capacity obligation on all LSEs could disadvantage ESPs and CCAs that may have to purchase incremental capacity from IOUs that possess market power and whose ratepayers have paid for the IOU-owned capacity.

Finally, the Commission must be mindful that some LSEs already have contracts in place for RA capacity for one or more years. If either approach (or a hybrid approach) is adopted, a "grandfathering" provision for existing RA capacity purchases must be established.

II.

THE ED'S MCC BUCKET PROPOSAL REQUIRES ADDITIONAL ANALYSIS

The current MCC bucket classification for RA resources is based on the hours of contractual availability of the generation facility. LSEs have entered into contracts for the purchase of RA capacity based on the current bucket classifications. In its March 23, 2012 Report, the ED states that with the increase in renewable generation, the current buckets "may not be accurate indicators of actual contribution to grid reliability." Report at p. 5. In this connection, the ED states that the current methodology does not account for the "dispatchability" of resources. Id.

Based upon this concern, the ED proposes to define MCC resource buckets based on "operational dispatchability" as well as "contractual hours of operation." The ED proposes to assign generation units to one of four MCC buckets based on "consistency of production and flexibility of dispatch." Id. at p. 6. The ED proposal provides a definition of dispatchability that incorporates a maximum ramp rate, a contractual obligation to be available for CAISO dispatch, and a maximum registered start-up time period (or a minimum down-time). Id. The ED proposal also distinguishes between facilities that operate for "unlimited hours" and facilities that operate for "restricted hours." Based on these characteristics, the ED proposes to allocate generation units among the four buckets.

The ED's proposed classification and allocation of generation units to the four MCC buckets raises issues demonstrating that further analysis is required. The ED's proposal, if adopted, would limit the amount of "inflexible" resources upon which an LSE may rely for RA compliance. This proposal would invariably devalue some RA resources.

If the Commission is inclined to adopt changes to the RA procurement requirement that would reduce the relative value of some RA resources, the Commission must be certain that the bucket classifications are meaningful with regard to system reliability, and that the allocation of resources among the buckets is accurate. In particular, the Commission must carefully consider the ED's proposed definitions of "dispatchability," "unlimited hours," and "restricted hours." Additional consideration should be given to whether the dispatchability of a resource is the best measure of the "flexibility" that is required for RA capacity. Moreover, the Commission must ensure that the ED cannot arbitrarily classify resources as "dispatchable" or "non-dispatchable" without input from the resource owner.

The ED's proposed allocation mechanism for the MCC buckets requires more detailed analysis. For example, the treatment of peaker units as Bucket 2 products does not account for the actual availability of the units. Peaker units are generally available 100 percent of the time that they are needed (i.e. during peak periods). The ED's analysis (Figure 8, page 15), however, shows that peaker units operate 45 percent of the time during August. On this basis, the ED proposes that Bucket 2 resources should be limited to 45 percent of an LSE's RA portfolio. See Report at p. 8.

Similarly, the ED's proposed classification of steam units as Bucket 3 non-dispatchable resources warrants further discussion. Both steam units and peakers afford needed flexibility to integrate renewable resources to meet the 33 percent RPS procurement requirement. Moreover, the ED's proposal must consider the value of the greenhouse gas emission reduction benefits associated with these facilities. It is counterintuitive to limit the amount of these resources that can be included in an LSE's RA portfolio.

The ED's analysis does not show peaker units' availability during the peak periods when they are needed. If the same logic used by the ED were to be applied to baseload combined cycle plants, combined cycle plants that have a 55 percent capacity factor during August (ED Report, Figure 8, page 15) would receive a 55 percent maximum counting value (rather than 100 percent as proposed by the ED). Inconsistencies and deficiencies underlying the analysis in the ED proposal create the potential for devaluing existing RA resources, resulting in significant economic harm to market participants. More analysis of the ED's MCC bucket proposal is required.

III.

THE CAISO'S FLEXIBLE CAPACITY PROPOSAL WOULD IMPOSE AN IMPROPER FORWARD PURCHASE MANDATE

In contrast to the ED's proposal to limit the quantity of "inflexible" resources in an LSE's portfolio, the CAISO's proposal would require LSEs to purchase a minimum quantity of "flexible" resource capacity. Without consideration of the impact on the competitive market, and without regard to the limits of CAISO authority, the CAISO's proposal seeks to have this Commission impose a mandate on LSEs to forward purchase flexible capacity products.

The CAISO's March 2, 2012 "Supplement" to its flexible capacity procurement proposal states that a need exists for operational flexibility in light of the combination of: a reduction of flexible resources due to the State's once-through cooling ("OTC") policy; and "revenue insufficiency" due to the displacement of traditional, flexible generation with intermittent renewable generation. See Supplement at p. 4. The CAISO asserts that three operational attributes - - "maximum continuous ramping;" "load following;" and "regulation" - - are "needed by the CAISO and can be applied on a resource-by-resource basis to assess the amount of flexible capacity each resource can provide." Id. at p. 5.

The CAISO proposes that the Commission adopt a flexible capacity procurement requirement for LSEs as a part of the 2013 RA program. Supplement at p. 25. The CAISO proposes that the Commission require LSEs to acquire a proportionate share of the amount of flexible capacity (maximum continuous ramping; load following; and regulation) as computed by the CAISO and published in July 2012. Id. The CAISO proposes that the Commission require LSEs to make an annual RA showing that reflects 90 percent of system procurement requirements (including flexible capacity requirements) for all months. Id. The CAISO also proposes that the Commission require LSEs to make monthly filings demonstrating that they have 100 percent of all RA capacity (system capacity; local capacity; and flexible capacity). Id.

The FERC-approved CAISO tariff provides the CAISO with ample authority to develop a market for flexible capacity products. The tariff provides that the CAISO is "responsible for ensuring that there are sufficient [a]ncillary [s]ervices available to maintain the reliability of the CAISO [c]ontrolled [g]rid . . . ." Tariff Section 8.1. Through the price paid for ancillary services, the CAISO provides incentives for generators to offer "regulation," "spinning reserves," and "non-spinning reserves." The costs of these operational services are paid by all customer load through charges imposed upon Scheduling Coordinators. Ancillary services are provided by generators through a competitive bidding mechanism. See CAISO Tariff, Sections 8.3.6; 8.3.7. Imposing an additional flexible capacity procurement obligation could result in duplicative costs to ratepayers.

If the CAISO believes that flexible capacity is needed, the CAISO can identify the products to be purchased based on its obligation to ensure that ancillary services remain available for their intended purpose to provide contingency reserves for grid reliability. The CAISO's creation of new flexible capacity products should help identify new products that may be needed to "firm" renewable supplies.

During the March 30 workshop, the CAISO suggested that new products should include "maximum continuous ramping" and "load following." These product naming conventions likely warrant further discussion, as noted during the workshop. For example, the load following product (energy dispatchable in less than 60 minutes) is very similar to the "replacement reserve" product once used by the CAISO. Furthermore, the maximum continuous ramping product is a dispatchable capacity product to provide instructed energy, very similar to the current imbalance energy market, RUC market, and non-contingency spin and non-spin markets. Developing a common nomenclature would be helpful to all market participants.

Once the CAISO identifies these flexible capacity products and specifies the corresponding load obligation, LSEs should be free to choose whether to purchase these products in bilateral transactions on a forward basis, or pay the cost of CAISO purchases in the spot market on behalf of their load. Rather than have the Commission impose a flexible capacity mandate as a part of the RA capacity procurement obligation, the CAISO should develop a market for flexible capacity products, and the Commission should allow the IOUs to procure the products in the most cost efficient manner if they seek to buy these products on a forward basis.

A flexible capacity requirement should not be added to an LSE's current RA capacity procurement obligation. Rather, flexible capacity should be an option to purchase should an LSE determine that this is the most cost effective procurement. Adding a flexible capacity requirement to an LSE's RA procurement obligation would increase costs to all ratepayers and disadvantage the customers of those LSEs that do not own or control generation.

Based on the CAISO's perceived need for flexible capacity, the CAISO should provide incentives for the purchase of flexible resources. For example, the CAISO could establish new "firming" products for integration of renewable energy, such as replacement reserve or imbalance energy capacity. The CAISO could state the quantity of those firming products that it would procure on behalf of load. The IOUs could then go to the Commission in the long-term procurement planning case ("LTPP") and request approval to procure these products and quantities in bilateral markets. The CAISO would procure the products daily and the IOUs would be hedged for their obligation based on their forward procurement. LSEs would then be in the position to make the determination as to the most economic procurement mechanism. Furthermore, transparency would develop in the forward markets if a transaction platform, such as ICE, were to be used to make bids and offers available to market participants and to clear those transactions.

The CAISO's flexible capacity procurement proposal suggests a long term procurement obligation that does not align the LSE's RA capacity requirement with the obligation of an LSE to serve its load. It is difficult (or impossible) for ESPs and CCAs to make capacity commitments for terms longer than a year. If the Commission is truly interested in ensuring that some level of retail competition remains in California through the direct access and CCA programs, it will be important to maintain a forward bilateral procurement option which aligns with an LSE's load obligation, which in recent years has centered around a one year procurement obligation.

IV.

CONCLUSION

The Commission should not impose an additional burden on LSEs and their customers by adding a layer of complexity and added cost to the RA procurement obligation. The ED's proposal to modify the MCC bucket classifications, and the CAISO's proposal to add a flexible capacity procurement requirement, appear mutually exclusive and should be discussed in greater detail in Phase 2 of this proceeding, or in another proceeding.

Flexible capacity procurement is a long term issue that requires careful analysis before implementation. The ED's MCC bucket proposal is in a preliminary stage of development; many questions about resource classifications and bucket allocations remain unanswered. The CAISO's flexible capacity proposal lacks justification and raises questions about whether a market mechanism can be developed to encourage flexible capacity procurement. Neither the ED proposal nor the CAISO proposal should be adopted for 2013.

Because the ED's proposal and the CAISO's proposal seek to achieve similar objectives, the Commission should assess these proposals through a detailed review in Phase 2. No new RA procurement obligation should be imposed on LSEs for the 2013 RA compliance year.

Respectfully submitted,

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