

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

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**COMMENTS OF  
SHELL ENERGY NORTH  
AMERICA (US), L.P.  
ON JOINT PARTIES' FLEXIBLE  
CAPACITY PROCUREMENT PROPOSAL**

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John W. Leslie  
McKenna Long & Aldridge LLP  
600 West Broadway, Suite 2600  
San Diego, California 92101  
Tel: (619) 699-2536  
Fax: (619) 232-8311  
E-Mail: [jleslie@mckennalong.com](mailto:jleslie@mckennalong.com)

Attorneys for Shell Energy North America  
(US), L.P.

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In accordance with the schedule established in the “Phase 2 Scoping Memo and Ruling” that was issued on December 6, 2012,<sup>1</sup> Shell Energy North America (US), L.P. (“Shell Energy”) files its comments on the interim “Flexible Capacity Procurement” proposal, appended to the Scoping Memo, that is sponsored by the CAISO, SDG&E, and SCE (“joint parties”). Shell Energy supports the study work being conducted by the CAISO, this Commission and others to ensure that sufficient flexible capacity resources are available to integrate the new renewable supplies that are needed to meet the State’s increased RPS procurement targets. Shell Energy opposes, however, the interim flexible capacity procurement proposal.

Implementation of a new resource adequacy (“RA”) mandate would add to end-use customers’ electricity rates without any showing that a need exists for flexible capacity during the interim period. Moreover, the joint parties’ proposal fails to provide a clear definition of “flexible capacity” that can be reflected in a standard capacity product. If the CAISO determines that flexible capacity is required over the interim (2014-2017) period, the CAISO can develop

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<sup>1</sup> In an e-mail Ruling dated December 19, 2012, Presiding Judge Gamson extended the deadline for comments to December 26, 2012.

flexible capacity products that can be provided from the existing fleet of resources through a market, like the market for ancillary services, that is managed by the CAISO. There is no basis for this Commission to impose a new, flexible RA capacity procurement mandate on all LSEs during this interim period.

If the Commission is inclined to adopt an interim flexible capacity procurement program, however, the program should be established on a trial (pilot) basis. A pilot program would allow the CAISO - - and the Commission - - to monitor RA capacity procurement and analyze the “gap,” if any, between the capacity that is purchased to meet load-serving entities’ (“LSE”) system RA requirements and the flexible capacity that is needed during critical ramping periods. If it is found that the existing fleet of resources is insufficient to meet projected ramping requirements in 2018 and beyond, the Commission will have the time - - and the information - - to determine flexible capacity need and establish procurement mechanisms that minimize costs to ratepayers.

Shell Energy’s comments herein respond to specific questions presented in “Attachment B” to the Scoping Memo.

## I.

### INTRODUCTION

The joint parties propose an interim flexible RA capacity procurement requirement (continuous three-hour ramping capacity) for all LSEs for the period 2014 – 2017. The joint parties propose that this flexible RA capacity requirement should be integrated into the Commission’s current bilateral RA capacity procurement program, based on the CAISO’s existing annual RA capacity needs assessment.

In support of their proposal, the joint parties state that as the State’s RPS and GHG emissions reduction policies are implemented and phased-in, the existing practice of procuring

only “generic” RA capacity, with no consideration of special resource attributes, will no longer ensure that the CAISO balancing area has an adequate supply of ramping capability and contingency reserves. The joint parties state that the RA program must be expanded to focus on procuring resources that are able to provide these flexibility functions.

The joint parties propose that the CAISO determine, on an annual basis, the multi-hour ramp need using a one-in-two year load forecast, and then estimate the largest ramping need for each month. The CAISO would forecast the expected peak load for the month to determine the capacity needed for contingency reserves, and then add the capacity needed for ramping and contingency reserves for each month. The joint parties recommend that during this interim period, the Commission should allocate flexible capacity procurement obligations to LSEs based on each LSE’s relative share of monthly system peak load.

The joint parties further propose that the Commission require LSEs to make both year-ahead and month-ahead showings for flexible capacity similar to the current requirement for system RA capacity. Under the joint parties’ proposal, each LSE would be required to demonstrate, in its year-ahead showing, that it has procured 90 percent of each monthly flexible capacity procurement obligation. Additionally, each LSE would be required to show, in its monthly submission, that 100 percent of its flexibility capacity procurement obligation has been procured for that month.

The joint parties also propose that flexible capacity resources should be subject to a more stringent "must-offer" obligation than is currently required for generic RA capacity in the CAISO market. The joint parties’ proposal would prevent self-scheduled facilities from qualifying for the flexible capacity requirement. The joint parties propose that the CAISO’s stakeholder process should be coordinated with this proceeding in order to develop the must-offer requirement.

## II.

### **SUMMARY OF SHELL ENERGY'S POSITION**

The Commission should reject the joint parties' proposal for an interim flexible RA capacity procurement mandate. The joint parties have failed to establish that the existing resource fleet is not adequate to meet flexibility requirements during the interim period. Moreover, the joint parties have not shown that there is a need for a mandatory flexible capacity procurement obligation during the period 2014-2017. A mandatory flexible capacity obligation would add to ratepayers' electricity costs without any demonstration that the CAISO cannot meet ramping needs with existing resources. The joint parties' proposal fails, in this regard, to address alternative means of meeting flexibility requirements during the interim period.

If the CAISO concludes that it needs "additional assurances" with respect to the availability of flexible resources, the CAISO can develop flexible capacity products and a market structure for the purchase of these products. This Commission can consider, in the LTPP proceeding (R.12-03-014), whether the IOUs should be allowed - - or required - - to purchase flexible products on a forward basis in order to hedge against the costs of acquiring flexible capacity on a short-term basis. The Commission should not impose a flexible capacity procurement obligation on all LSEs, however.

The Scoping Memo asks what are the "specific impacts" of a flexible capacity procurement obligation on ESPs and CCAs. See Attachment B, Question H.18. As the Commission is aware, most of the resources that can provide ramping capability are controlled by the IOUs. If ESPs and CCAs are required to meet a flexible capacity procurement obligation, the IOUs will be selling their capacity to ESPs and CCAs, effecting a transfer of wealth from direct access customers and CCA customers to the IOUs. This wealth transfer is simply not justified.

In this proceeding, the Commission should address a definition of “flexible capacity” and a quantification of the flexible capacity needed for system reliability. Based on this determination, the CAISO can develop a market structure for the purchase of new flexible capacity products. Whether the IOUs should purchase flexible capacity should be addressed in the LTPP proceeding.

In the alternative, if the Commission decides to impose an interim flexible capacity procurement obligation on all LSEs, the Commission should adopt a “pilot” program that operates on a trial basis. During this period, LSEs would have the opportunity to focus their RA capacity purchases on resources that are “dispatchable.” The Commission (and the CAISO) could analyze the “gap” between the RA capacity that is actually purchased, and the flexible capacity that is needed during critical ramping periods. If the CAISO decides that incremental flexible capacity is required for grid reliability, the CAISO can establish new products and a market for trading these flexibility products.

### **III.**

#### **THE COMMISSION SHOULD REJECT THE JOINT PARTIES’ PROPOSED INTERIM FLEXIBLE CAPACITY PROCUREMENT REQUIREMENT**

The joint parties’ proposal states that the CAISO, this Commission, and other local regulatory authorities “must ensure that the supply fleet has sufficient flexibility . . . to satisfy ramping and intra-hour variability needs, including sufficient contingency reserves to ensure the security and safety of the grid.” Proposal at p. 3. The joint parties seek to meet this requirement through the adoption of a “mandate” - - a new, flexible RA capacity procurement obligation that is to be imposed on all LSEs. The joint parties have not defined “flexible capacity” in sufficient detail to enable LSEs to identify or value a flexible capacity product. Moreover, the joint parties propose a new mandate without an assessment of the added cost of flexible capacity, and without

consideration of other means by which the CAISO can ensure that it has sufficient flexible resources to manage grid reliability.

Imposing a new flexible capacity procurement obligation would add another layer of complexity - - and cost - - to LSEs' RA procurement obligations. Moreover, mandating LSE procurement of "flexible" RA capacity would increase costs for all electricity customers, without any demonstration that a refinement 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. The Commission should consider this approach for the IOUs in the LTPP proceeding.

Imposing an additional RA capacity obligation on all LSEs, however, would disadvantage ESPs and CCAs in favor of the IOUs. ESPs and CCAs would have to purchase incremental flexible capacity from IOUs that may possess market power and whose ratepayers have paid for the IOU-owned capacity. In this regard, the joint parties' proposal to require LSEs to purchase additional capacity seems intended to increase the subscription to generation that may be "stranded" at this time.

The joint parties note that "[a]s the build out of intermittent resources continues and the ramping needs become clearer, specific products and better methods for determining and allocating the flexible capacity procurement obligation must be developed." Proposal at p. 8. The joint parties have failed, however, to explain why, at this time, it is necessary to impose a flexible capacity procurement mandate on all LSEs. Other market-based (and less costly) means are available to the CAISO to ensure that flexible capacity needs are met during this interim period.

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 to provide contingency reserves for grid reliability. The CAISO's establishment of new flexible capacity or balancing reserve products would help to "firm" the increased deliveries from renewable supplies that are anticipated under the 33 percent RPS requirement.

The Scoping Memo raises the issue of whether there are "other options" to address underlying reliability risks. See Attachment B, Question A.2.c. The answer is "yes." The CAISO's tariff provides 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 balancing reserves<sup>2</sup> or 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. The CAISO can establish a voluntary market for flexible capacity that is similar to the market for ancillary services.

Once the CAISO identifies the flexible capacity products that are needed 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 an LSE's RA capacity procurement obligation, the CAISO should develop a market for flexible capacity products. The Commission should allow the IOUs to procure these

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<sup>2</sup> The CAISO once had a "replacement reserve" product that provided energy within one hour. This product was discontinued, however. Based on recent representations by the CAISO regarding the need for flexible capacity, it now appears that such a "replacement reserve" may be one of the new flexible capacity products needed.



products in the most cost efficient manner, including the purchase of these products through the bilateral market on a forward basis. The Commission should authorize the IOUs to procure flexible capacity products as a hedge against the CAISO's daily clearing of those products, similar to the current CAISO ancillary services markets.<sup>3</sup>

A flexible capacity requirement should not be added to an LSE's current RA capacity procurement obligation. To overlay a flexible capacity obligation on the standard capacity product would be unduly complex, particularly when "flexible capacity" has not been adequately defined. Imposing a flexible capacity mandate would increase the number of products and product markets, thereby increasing the potential for the exercise of market power with respect to any specific capacity product.

Flexible capacity should be an option for an LSE to purchase if the LSE determines that this is the most cost effective means of serving its load. The IOUs should be allowed to propose, in their long-term procurement plans, purchases of flexible capacity in bilateral markets in order to hedge against the cost of flexible capacity purchased for load by the CAISO. There is no reason to impose a flexible capacity obligation on ESPs and CCAs.

#### IV.

#### **THE FLEXIBLE CAPACITY PROCUREMENT PROPOSAL WOULD DISRUPT EXISTING CONTRACTS**

The Scoping Memo asks about the impact of an interim flexible capacity obligation on existing contracts. See Attachment B, Question B.3. The joint parties' proposal, if adopted in its current form, would disadvantage certain existing facilities, and could disrupt existing contractual relationships. For example, the joint parties state that "[b]ecause current RA

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<sup>3</sup> Today, the IOUs can procure ancillary services capacity (to which they have access through tolling agreements and utility-owned generation) and then bid that capacity into the CAISO ancillary services markets. The IOUs can then bid in ancillary services equal to their load obligation and net out (get charged and paid for) their supply and their obligation.

resources can meet their must-offer obligation by self-scheduling, they may not actually be available for dispatch by the [CAISO], and, therefore, are not ‘flexible.’” Proposal at p. 11. Self-scheduled units can provide incremental or decremental bids, however, to provide flexibility. Contracts that provide for the self-scheduling of specific resources could be undermined if self-scheduled facilities are not eligible for flexible capacity procurement.

The Scoping Memo asks whether it is appropriate to exclude self-scheduled resources from counting toward flexibility. See Attachment B, Question E.9.c. The answer is “no.”

The Scoping Memo also asks whether “three-hour ramping” capability is the appropriate measure of “flexibility.” See Attachment B, Question C.5.a. The joint parties fail to explain why a three-hour “ramp” is necessary to qualify as flexible capacity. The joint parties state that “three-hour ramping capabilities offered the best single characteristic to ensure the [CAISO] could meet its ramping and contingency needs and enable a large pool of resources to qualify as flexible capacity resources.” Proposal at p. 12. The joint parties note, however, that “load following” and “regulation” are not included within the meaning of flexible capacity for purposes of this proposal. See Proposal at p. 6. The joint parties do not adequately explain why facilities with certain operating characteristics will be eligible as flexible capacity, while facilities that do not have three-hour ramping capability will not qualify as flexible capacity.

If a flexible capacity procurement obligation is adopted, the Scoping Memo asks what alternatives exist within the Commission’s jurisdiction to allow LSEs to demonstrate compliance. See Attachment B, Question D.8.a. This question raises the issue of the increased cost and complexity associated with the joint parties’ proposal. The joint parties propose that an LSE’s year-ahead showing must demonstrate that the LSE has procured 90 percent of each month’s flexible capacity procurement obligation. Contrary to the current system RA requirement, an LSE’s year-ahead filing will have to demonstrate compliance with a different

RA capacity requirement in each month. This obligation would make it more difficult - - and more expensive - - to contract for flexible RA capacity on a forward basis, because the need for flexible capacity varies from one month to the next. The joint parties' proposal would add unnecessarily to the RA capacity costs borne by all electricity customers.

V.

**IF AN INTERIM FLEXIBLE CAPACITY PROCUREMENT OBLIGATION WERE TO BE ENTERTAINED, IT SHOULD BE THROUGH A PILOT PROGRAM**

The joint parties propose a new RA capacity mandate that promises, during the interim period, to impose additional costs on ratepayers, as well as impose additional costs and burdens on LSEs. The joint parties also propose, during this interim period, that the Commission impose monetary penalties for deficiencies in LSE performance. The joint parties' proposal envisions a comprehensive, expensive program that is designed for an "interim" period. In view of the magnitude of the new obligations envisioned in the flexible capacity procurement proposal, if the Commission decides to proceed with this program, it should do so on a trial basis, through a "pilot."

Under a pilot program, LSEs can be encouraged to meet their system RA requirements through contracts with dispatchable resources. The Commission - - and the CAISO - - can monitor RA capacity purchases and determine whether (and if so, to what extent) there is a "gap" between the flexibility characteristics in the RA capacity that is purchased, and the flexible capacity that is needed during the applicable ramping period. Based on their findings under the pilot program, the CAISO can determine whether specific products - - and a market for these products - - should be developed in order to meet the future need for flexible capacity. This trial period pilot approach would significantly reduce costs to ratepayers, and could eliminate any need for an additional RA capacity product.

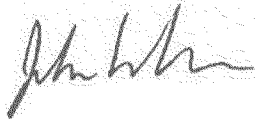
## VI.

### CONCLUSION

The joint parties have not established that a flexible capacity procurement obligation is needed, or that the Commission should impose a flexible capacity procurement mandate. Although the Commission might consider how to define “flexible capacity” in the RA proceeding, any consideration of a flexible procurement obligation (limited to the IOUs) should be addressed in the LTPP proceeding. The CAISO can develop flexible capacity products that can be traded in a CAISO-managed market if it determines that additional flexibility is required during the interim period.

In the alternative, if the Commission decides to adopt an interim flexible RA capacity procurement requirement, the Commission should adopt a “pilot” program that encourages the purchase of RA capacity with flexibility characteristics. Based on this pilot program, the Commission - - and the CAISO - - can monitor RA capacity purchases and determine if there is a “gap” between actual RA capacity procurement and the flexible capacity that is needed to integrate renewable supplies.

Respectfully submitted,



John W. Leslie  
McKenna Long & Aldridge LLP  
600 West Broadway, Suite 2600  
San Diego, California 92101  
Tel: (619) 699-2536  
Fax: (619) 232-8311  
E-Mail: [jleslie@mckennalong.com](mailto:jleslie@mckennalong.com)

Date: December 26, 2012

Attorneys for Shell Energy North America (US) L.P.