Decision **DRAFT DECISION OF ALJ WETZELL (Mailed 3/7/2005)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)

SECOND INTERIM OPINION REGARDING RESOURCE ADEQUACY

1. Summary

The Commission's October 28, 2004 *Interim Opinion Regarding Resource Adequacy* (Decision (D.) 04-10-035) is modified, as set forth herein, to clarify and restate the Commission's policy for resource adequacy requirements (RAR). In particular, the nature of the forward commitment obligation is specified.

2. Background and Procedural History

D.04-01-050 adopted key policies for RAR that are applicable to the three major investor-owned utilities, energy service providers, and community choice aggregators (collectively, load serving entities or LSEs). D.04-10-035 was subsequently issued in this docket to provide definition and clarification with respect to the RAR policy framework adopted in D.04-01-050. The latter decision left for resolution in RAR Phase 2 important implementation details such as compliance, sanctions, locational procurement, load forecasting conventions, the relationship between the year-ahead and the month-ahead obligation, and the precise nature of the system support requirements that all qualifying resources must satisfy.

On November 4, 2004, the Administrative Law Judge (ALJ) issued a ruling initiating a workshop process to resolve the outstanding issues in Phase 2, and the Commission sponsored 16 RAR workshop sessions from November 30, 2004 through February 9, 2005. In the course of these workshops it became apparent to the workshop facilitators that a portion of D.04-10-035 pertaining to the nature of the forward commitment obligation requires clarification. Accordingly, on February 8, 2005, the Assigned Commissioner issued a ruling (February 8 ACR) providing an opportunity for parties to submit comments and replies on possible modifications to D.04-10-035 that pertain to the nature of the forward commitment obligation. The February 8 ACR determined that this is a threshold issue whose resolution could significantly impact the consideration of other issues in Phase 2 of the RAR track of this rulemaking, and it therefore set an expedited schedule for comments and replies

Comments in response to the February 8 ACR were filed by the California Independent System Operator (CAISO); Duke Energy North America (DENA); the Independent Energy Producers Association (IEP); the Office of Ratepayer Advocates (ORA); Pacific Gas and Electric Company (PG&E); Powerex Corp (Powerex); San Diego Gas & Electric Company (SDG&E); Sempra Global (Sempra); and jointly by Southern California Edison Company, The Utility Reform Network (TURN), California Large Energy Consumers Association, California Manufacturers and Technology Association, and Alliance for Retail Energy Markets (Joint Parties). Reply comments were filed by the CAISO; IEP; Joint Parties, ORA; PG&E; and TURN.[1]

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[1] TURN, which also joined in the reply comments of Joint Parties, submitted supplemental reply comments.

In broadest terms, the commenting parties generally fall into two categories: (1) those who either support or would accept, in most cases with qualifications, the ACR's approach of requiring LSEs to acquire capacity resources to cover load and the 15%-17% planning reserve margin (PRM) for all hours of the year (all hours approach); and (2) those who support adoption of an obligation for LSEs to acquire capacity and the PRM only during those hours when load is greater than or equal to 90% of peak load (peak hours approach), in combination with an all hours local area obligation. Supporters of the all hours approach generally support either the monthly peak load alternative identified in the ACR or a seasonal approach. There is essentially no support for adoption of the annual peak load alternative that was also identified in the ACR.

3. Discussion

3.1. Introduction

The February 8 ACR was issued for the limited purpose of resolving threshold questions regarding the nature of the RAR forward commitment obligation that arose from apparent inconsistencies in D.04-10-035. As discussed below, we concur that D.04-10-035 contains inconsistent passages that should be clarified. We do not concur with Sempra's view that the inconsistencies should be resolved after the Phase 2 workshop report is issued, and after details about the CAISO wholesale market design are revealed. We recognize that developing an RAR program at the same time that the CAISO is pursuing resolution of wholesale market design issues presents unique problems because the two processes are intertwined. We believe that on balance, the comments on the Phase 2 workshop report that will be submitted in the near future will be better informed and more useful to the Commission if they are informed by the policy preferences we express today. We affirm the ACR's determination that

uncertainty regarding the nature of the forward commitment obligation is a threshold issue whose early resolution could promote fair and efficient consideration of the issues in Phase 2.

Some comments, while thoughtful and germane to Phase 2, go beyond the limited purpose of the ACR. Except to the extent necessary to provide guidance to the parties on the threshold question of the forward commitment obligation, we prefer to defer the resolution of Phase 2 RAR issues until the Phase 2 workshop and comment process has been completed. In this interim decision, we do not intend to respond to comments that do not pertain to this limited purpose.

3.2. Inconsistent Language

The February 8 ACR found that Section 3.1 of D.04-10-035 ("Nature of the Obligation to be Satisfied" at pp. 9-11) contains inconsistent passages explaining the nature of the reserve obligation that LSEs must satisfy. The ACR quoted the following statements from D.04-10-035, certain of which appear to support an interpretation that resources must be acquired to meet load plus reserves for every hour of every month of the year and others of which appear to support an interpretation that the RAR obligation is a more limited obligation that applies to defined peak periods:

> "While D.04-01-050 did not require a 90% forward commitment for the non-summer months, we clarify here that the 15-17% reserve requirement applies to the entire year. Indeed, anything short of a year round reserve requirement would constitute sub-optimal and inadequate assurance of grid reliability." (D.04-10-035, p. 9.)
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> "The resources that "stack up" to satisfy load and the 15-17% PRM for each hour of a month can be different." (*Id.*, p. 11.)
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> "CAISO in its reply comments suggests that the obligation be for those hours in which load is greater than or equal to 90% of peak load. Examining historical data, CAISO identifies a range of 10-12 hours per year in which system load is 90% or greater of the absolute peak for that year…..Thus, we will require that LSEs acquire a mix of resources capable of satisfying the number of hours for each month that their loads are within 10% of their maximum contribution to monthly system peak." (*Id.*, p. 10).

Joint Parties do not agree with the ACR's underlying assessment that conflicts exist within D.04-10-035. They state that:

> "…the ACR creates conflict in D.04-10-035 regarding the issue of a peak hour RAR that extends to all hours, where no such conflict exists. The ACR quotes, out of context, statements which it claims support an interpretation that requires resource adequacy resources to be acquired to meet load plus reserves for every hour of the year. [Footnote omitted.] When read in context, it is clear that the first statement set forth in the ACR as support for an 8,760 hour requirement, only clarified the Commission's intent to have every month of the year covered by a resource adequacy requirement (as opposed to only the months May-September, as had been set forth in D.04-01-050), not as having any bearing on the question of an all-hours requirement.[2] This is consistent with the record leading up to D.04-01-050. No analysis was ever presented to the CPUC which would now justify an 8,760 hour per year peak-load RAR. Accordingly, the CPUC cannot justify the imposition of a peak hour RAR that extends to all hours (monthly or annually) as what the

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[2] In a footnote at this point, the Joint Parties' Comments state: "In the sentence preceding the Commission's quote Decision No. 04-01-035 states 'D.04-01-050 clearly established the obligation for LSEs to acquire resources to cover peak loads plus 15%-17% planning reserves. In addition, the Order provided for a 90% forward commitment for each of the summer months of May through September. In this context, it is clear that the Commission's decision in D.04-10-035 was not to make a statement about hourly commitments, but rather to clarify that all months, not simply summer months must be covered by the RAR commitment."

Commission originally intended in D.04-10-035." (Joint Parties' Comments, pp. 10-11.)

Even if, as Joint Parties point out, the statement that "the 15-17% reserve requirement applies to the entire year" can be explained in context as making a statement about applicability of the PRM to all months of the year (i.e., not to *all hours* of all months of the year), Joint Parties do not adequately address the statement in D.04-10-035 that "resources that "stack up" to satisfy load and the 15-17% PRM for *each hour* of a month can be different." (Emphasis added.) Upon reviewing Section 3.1 and other portions of D.04-10-035, we conclude that parties favoring both the all hours and the peak hours approaches can find support for the idea that their respective positions were approved by the Commission.

In any event, it is undeniable that the various passages in D.04-10-035 have led to some confusion among parties and staff regarding the Commission's intent for RAR. Rather than let the matter fester until Phase 2 is resolved, we prefer to provide clarification of our RAR policy at this time, and to make any modifications to D.04-10-035 that may be necessary to provide such clarification.

Joint Parties contend that we "cannot justify the imposition of a peak hour RAR that extends to all hours (monthly or annually) as what the Commission originally intended in D.04-10-035." This begs the question. The February 8 ACR provided notice to parties that the Commission will consider modifications to D.04-10-035 that could include adoption of an all-hours approach to RAR, and provided parties with an opportunity to comment on such modifications.

3.3. RAR Policy

Having determined there is a need for clarification of D.04-10-035, we turn to the larger task of stating the appropriate RAR policy going forward. In particular, we address whether an all hours or a peak hours approach best meets our objectives for RAR, and if the former approach is preferred, whether an annual peak, seasonal peaks, or monthly peaks should be used.

We begin by briefly revisiting our stated policies for RAR. The Commission stated in D.04-01-050 that it was "providing a framework to ensure resource adequacy by laying a foundation for the required infrastructure investment and assuring that capacity is available when and where it is needed." (D.04-01-050, p. 11.) Two key element of this framework are the obligation of LSEs to acquire sufficient resources and reserves to cover their customers' loads and the obligation of LSEs to forward contract 90% of their summer peaking needs a year in advance. (*Id.*) Among other things, the Commission noted that its resource adequacy actions should work in conjunction with efforts by CAISO and the Federal Energy Regulatory Commission (FERC) to redesign energy markets. (*Id.*, p. 17.)

As noted earlier, D.04-10-035 was an interim decision issued to clarify and further define RAR policies. In addition to addressing the nature of the RAR obligation to be satisfied, which is the topic before us today, the Commission (among other things) adopted a year-round month-ahead 100% forward commitment obligation and it established a general policy for "system support" that requires resources not scheduled by the LSE to bid into day-ahead markets.

Based on these policy decisions, we now state the following policies and principles pertaining to the nature of the RAR forward commitment obligation at

issue today. This is, in significant part, no more than a compilation and restatement of our previously adopted policies.

- A goal of the RAR regulatory framework is ensuring that infrastructure investment required for reliable service in the investor-owned utility service territories occurs on a timely basis.

- A related RAR goal is to ensure grid reliability during all hours of the year by assuring that capacity is available when and where it is needed.

- The goals of assuring infrastructure investment and assuring capacity availability should be accomplished at the lowest reasonable cost.

- The infrastructure investment costs and operational costs of making capacity available when and where it is needed should be fairly apportioned among the classes of LSEs and their customers.

- The Commission's RAR framework should be consistent and compatible with the CAISO wholesale market design now being developed, and not work at cross purposes with the CAISO.

We are persuaded that an all hours approach best achieves our goals and principles for RAR. An all hours obligation should best ensure that on any given day, a sufficient set of resources exists from which load can be efficiently served, operating reserves can be procured, and assurance is provided that capacity is on line to serve load. We are concerned that failure to pursue this form of obligation would unduly limit the CAISO's access to the resources needed to operate the grid, in frustration of our goal that capacity be available when and where it is needed. We are also concerned that the peak hours approach, even in combination with an all hours local obligation, would not adequately support the

CAISO market design, which relies on an expansive availability obligation. Finally, we are persuaded that the all hours approach is more consistent with our establishment of the RAR obligation as a capacity obligation.

In order to give effect to the principle that the Commission's RAR obligation should be compatible with the CAISO program objectives, we will provide that eligible capacity, i.e., that which counts towards the LSE resource obligation, must be made available to the CAISO for system dispatch during all hours for which the resource is declared by the LSE as meeting the LSE's RAR obligation. This requirement may be conditioned by reasonable use and energy limitations. We concur with IEP's observation that the availability obligation must be symmetrical, i.e., if the RAR obligation is year-round, the availability obligation is also year-round, and if the RAR obligation is monthly, the availability obligation is monthly.

The principle objection to the all hours approach is articulated by the Joint Parties. They believe that the approach will result in unneeded and costly procurement in off-peak hours to replace resources that exist specifically to meet on-peak loads. Joint Parties provide the following illustration:

> "For example, if August is assumed to be the peak month for the year, and an LSE's August load is forecast to be 1,000 MW, the LSE's obligation for that month, as previously specified by the CPUC, would be 1,150 MW, demonstrated for the top 10% of the load hours forecast for the month of August. If the CPUC is stating that a demonstration must be made that 150 MW of reserves are being supplied through the LSEs procurement in all 744 hours of August (for example, during a minimum load of 400 MW, the LSE must demonstrate 400 + 150 = 550 MW in its portfolio for this hour), such a demonstration might be cumbersome, but no additional unneeded off-peak procurement would likely be required. If the CPUC intends to impose a requirement that 1,150 MW of resources be available each and every hour of the month, including during a minimum

> load hour of 400 MW (thus resulting in a reserve margin for this hour of 187.5% - 750 MW reserves on a 400 MW load), then additional off-peak procurement would be necessary for compliance." (Joint Parties' Comments, p. 9.)
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> "Additionally, if the existing resource portfolio provides 700 MW during the off-peak hours, thus resulting in a highly reliable 75% reserve margin during those hours (700 MW serving a 400 MW load for a 300 MW reserve margin or RM = 300/400 = 75%), the new requirement would result in the need for an additional 450 MW of off-peak procurement! This procurement would add cost, but not be needed for reliability. Of course if the new requirement were to be based on an annual peak capacity plus reserve requirement in all hours of the year, and the minimum load hour in April were only 200 MW, with other assumptions as described above, the conclusion regarding unneeded procurement would be further exacerbated. It is incomprehensible why LSEs should be required to bear the cost of increasing reserve margins during off-peak hours to levels far in excess of 115% level the Commission has deemed sufficient the meet California's reliability needs at the time of the peak." (*Id.*, pp. 9-10.)

We are persuaded that the all hours approach need not lead to such wasteful and unnecessary procurement as the Joint Parties portray. However, our RAR program must give due recognition to the nature of resources that meet peak obligations and the fact that some of these resources are not available at non-peak hours. CAISO contends that in its market design, it has recognized and provided for the need to accommodate resources with legitimate use limitations within an all hours must-offer obligation. CAISO maintains that its dispatch protocols will manage the available capacity so that resource adequacy units that have limitations are committed and dispatched during those hours when they are most needed. CAISO recognizes that it would be appropriate to establish a special case definition for any such RAR resources so that the LSE can provide evidence as to the resource limitation and communicate such evidence to the

CAISO for use in optimal dispatch. Clearly, these safeguards that are recognized as necessary by the CAISO must be an integral component of our adopted all hours approach.

We turn to the annual and monthly peak alternatives and the seasonal variations suggested by various parties. First, we will not adopt an all hours obligation that is based on the annual peak. No party support this approach, and almost all parties have provided sound reasons for its rejection as both costly and unnecessary. The choice between a monthly peak obligation and a seasonal obligation may rest largely on making a choice between greater flexibility and lower cost (monthly peak) and greater reliability at higher cost (seasonal obligation), although this is not entirely clear. We believe that it is most reasonable to embark on an RAR program with a monthly approach. This should allow the LSE's RAR obligation to better follow its load profile and minimize the likelihood of a requirement to replace capacity at times that it is not truly needed. Once we have gained experience with this requirement, it may be appropriate to further consider this choice. We note, as Sempra observes, that a monthly peak all hours obligation will not limit LSEs and generators to month-to-month contracts.

3.4 Modifications to D.04-10-035

Consistent with the foregoing discussion, we will modify D.04-10-035 to conform to the adopted all hours approach. Specifically, we will make appropriate modifications to Section 3.1, Finding of Fact 1, and Conclusion of Law 2, as set forth in the following order.

4. Need for Expedited Consideration

Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure provides in relevant part that:

> "…the Commission may reduce or waive the period for public review and comment under this rule regarding draft decisions…for a decision where the Commission determines, on the motion of a party or on its own motion, that public necessity requires reduction or waiver of the 30-day period for public review and comment. For purposes of this subsection, 'public necessity' refers to circumstances in which the public interest in the Commission adopting a decision before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment. 'Public necessity' includes, without limitation, circumstances where failure to adopt a decision before expiration of the 30-day review and comment period…would cause significant harm to public health or welfare. When acting pursuant to this subsection, the Commission will provide such reduced period for public review and comment as is consistent with the public necessity requiring reduction or waiver."

We balance the public interest in (a) quickly clarifying and modifying D.04-10-035 to enable establishment of a resource adequacy program that can enhance electric system reliability in 2006 and beyond against (b) the public interest in having a full 30-day comment cycle on the proposed modifications. We conclude that the former outweighs the latter. The clarifications and modifications adopted herein affect public health, safety and welfare by providing clarification and policy direction necessary for development of our resource adequacy program that will increase electric reliability in 2006. Any delay in implementing these clarifications and modifications would cause significant harm to public health and welfare by unreasonably and unnecessarily compromising system reliability. We seek valuable public review of, and

comment on, our proposed changes, and find that a reduced period balances the need for that input with the need for timely action.

5. Comments on Draft Decision

Parties to the proceeding may file comments on the draft decision on March 11, 2005, as the Commission is reducing the comment period pursuant to Rule 77.7(f)(9). (Article 19 of the Commission's "Rules of Practice and Procedure.") These rules are accessible on the Commission's website at **http://www.cpuc.ca.gov**. Pursuant to Rule 77.3 comments shall not exceed 15 pages. No reply comments will be entertained.

6. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Mark S. Wetzell is the assigned ALJ for the RAR portion in this proceeding.

Findings of Fact

1. The February 8 ACR provided notice pursuant to Pub. Util. Code § 1708 that D.04-10-035 may be modified with respect to the nature of the forward commitment obligation, and it provided an opportunity for parties to file comments and replies on such modifications.

2. D.04-10-035 contains inconsistent passages regarding the nature of the forward commitment obligation to be imposed on LSEs.

3. In D.04-01-050, the Commission expressed resource adequacy policies that included (a) ensuring required infrastructure investment, (b) assuring that capacity is available when and where it is needed, and (c) providing that resource adequacy actions should work in conjunction with efforts by CAISO and FERC to redesign energy markets.

4. To avoid the need for costly and unnecessary resource acquisitions by LSEs, the safeguards pertaining to limited availability resources that are

recognized as necessary by the CAISO must be an integral component of the adopted all hours approach.

5. Compared to an annual or a seasonal peak approach, a monthly peak approach will allow the LSE's RAR obligation to better follow its load profile and minimize the likelihood of a requirement to replace capacity at times that it is not truly needed.

6. Delay in the issuance of clarifications to D.04-10-035 could delay the implementation and effectiveness of the Commission's resource adequacy program that will increase electric reliability in 2006 and beyond, which adversely affects public health, safety and welfare.

Conclusions of Law

1. Inconsistencies in D.04-10-035 regarding the nature of the forward commitment obligation should be resolved by adopting an all hours policy as set forth in the foregoing discussion.

2. The public's interest in the timely adoption of the clarifications and modifications herein outweighs the public's interest in having a full 30-day comment cycle on the proposed modifications.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Decision 04-10-035 is modified as follows.

   a. The third sentence of the first paragraph of Section 3.1 is modified to read: "While D.04-01-050 did not require a 90% forward commitment for the non-summer months, we clarify here that the 15-17% planning reserve requirement applies to <u>all hours of</u> the entire year."

b. The second and third full paragraphs of Section 3.1 are deleted.

c. The second sentence of the fourth paragraph of Section 3.1 is modified to read: "In general, we intend that each LSE must show that it has acquired resources that satisfy ~~a series of loads~~ the peak load of that LSE for each month as modified by a coincidence adjustment."

d. Finding of Fact 1 is deleted.

e. Conclusion of Law 2 is modified to read: "LSEs should acquire a mix of resources capable of satisfying their own ~~the number of hours for each month that their loads are within 10% of their maximum contribution to~~ monthly ~~system~~ peak as modified by a coincidence adjustment."

2. This proceeding remains open.

This order is effective today.

Dated _____, at San Francisco, California.