

May 28, 2013

**COMMENTS ON BEHALF OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON,
PASADENA, AND RIVERSIDE, CALIFORNIA ON THE STRAW PROPOSAL ON
CONTINGENCY MODELING ENHANCEMENTS**

In response to the ISO's request, the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, the "Six Cities") submit the following comments on the ISO's May 15, 2013 Straw Proposal on Contingency Modeling Enhancements (the "Straw Proposal").

As the Six Cities understand the Straw Proposal, the ISO proposes the contingency modeling enhancements in an attempt to achieve the following objectives: (i) to improve the probability that the ISO grid will be able to meet SOL requirements (*i.e.*, restoration of stable system operating conditions within thirty minutes) following an N-1-1 contingency; and (ii) to improve efficiency in meeting SOL requirements by relying on a market mechanism and reducing reliance on Exceptional Dispatch and Minimum Operating Constraints ("MOC"). The Six Cities consider these objectives worthwhile and support further evaluation of the potential benefits of contingency modeling enhancements. It is critical, however, that the evaluation process include detailed consideration of at least three factors that the ISO has not yet addressed: (i) the cost of implementing the modeling changes; (ii) the potential for the exercise of market power if the modeling changes are implemented and the measures that will be required to mitigate market power; and (iii) the interactions of the proposed modeling changes with other market design features that are either in place (*e.g.*, convergence bidding) or under development (*e.g.*, the Energy Imbalance Market). All of these factors will affect the likelihood that the contingency modeling changes in fact will meet the stated objectives of improved reliability and efficiency, and they will affect the associated costs.

The Six Cities are concerned that the ISO has persuaded itself that the contingency modeling changes should be implemented based upon a theoretical analysis of potential benefits. Theoretical benefits, however, do not necessarily materialize in practice. The effects of convergence bidding in the ISO's markets provide a dramatic case in point. FERC encouraged and the ISO implemented convergence bidding based on the expectation that it would lead to market benefits, including expanded competition, convergence between day-ahead and real-time prices, and improved day-ahead unit commitment. *See, Calif. Indep. Sys. Operator*, 143 FERC ¶ 61,087 at PP 5-6 (2013). Instead, as implemented in the ISO's markets, convergence bidding has allowed speculators to extract more than \$100 million from ISO load, first by exploiting systematic differences between HASP and real-time prices until convergence bidding at the interties was suspended (*Id.* at P 67, n.128) and then by profiting from differences between day-ahead congestion and real-time congestion (Department of Market Monitoring 2012 Annual Report on Market Issues and Performance at 8-9), all without making any meaningful contribution to efficiency or improved convergence between day-ahead and real-time prices. While this stakeholder initiative is not the proper forum for a comprehensive evaluation of the benefits versus burdens of convergence bidding, the ISO's experience with convergence bidding provides a compelling example of the fact that unintended consequences are a potential if not likely result of introducing market design changes in markets as complex as the ISO's based on theoretical benefits.

As related to this specific stakeholder initiative, the ISO has not explained clearly how convergence bidding would affect the ability of the contingency modeling changes to satisfy the objective of enhancing the probability that the ISO will be able to recover from an N-1-1 contingency within the required thirty minute period. As emphasized in the Straw Proposal (*e.g.*, at page 12), the requirements for post-contingency recovery are flow-based. Convergence bidding, however, results in virtual flows that may either add to or offset physical flows. If virtual bids are included in the optimization used to select resources for corrective capacity under the proposed contingency modeling approach, how can the ISO be confident that the selected resources will be effective in recovering from an actual contingency leading to a post-contingency topology that may be very different from the combination of virtual and physical flows utilized in the optimization process? The Straw Proposal suggests at page 13 that one disadvantage of the current practice of using MOC constraints (along with Exceptional Dispatch) to address SOL requirements is that the ISO cannot be certain that a MOC constraint will be effective in maintaining reliability until an actual contingency occurs. Given the impact of virtual flows in the outcome of the proposed optimization process, however, it appears that the proposed contingency modeling approach could lead to reduced, rather than greater, confidence in the ISO's ability to meet SOL requirements.

The Straw Proposal emphasizes (*e.g.*, at page 16) that FERC has directed the ISO to seek to reduce the incidence of Exceptional Dispatch. However, FERC has never suggested that the ISO must minimize Exceptional Dispatch without any consideration of cost impacts. According to the Department of Market Monitoring Annual Report, total above-market costs for Exceptional Dispatch in 2012 were approximately \$34 million, and, considering that Exceptional Dispatch volumes due to SOL requirements were approximately 40% of annual Exceptional Dispatch volumes, a substantial portion of that total undoubtedly was associated with Exceptional Dispatch to address needs other than satisfaction of SOL requirements. The Straw Proposal provides no basis for assessing the relative costs of addressing SOL requirements through Exceptional Dispatch versus implementation of the proposed contingency modeling approach.

With respect to market power, the Straw Proposal acknowledges at pages 26-27 the potential for the exercise of market power under circumstances identified by the DMM. The Straw Proposal suggests, however, that market power mitigation measures need not be considered in this stakeholder initiative, because the concerns identified by the DMM apply generally to capacity products and, therefore, "are not originated from this contingency modeling enhancement initiative" This dismissive response to an identified market power concern is insufficient. It seems apparent that implementation of the contingency modeling changes would expand opportunities for the exercise of market power over capacity products. Measures to effectively mitigate the exercise of market power should be developed on a preventive basis, not after it occurs and imposes substantial costs on customers.

While the Straw Proposal asserts (*e.g.*, at pages 38-39) that the proposed contingency modeling changes will result in the most efficient selection of resources to satisfy SOL requirements, that conclusion is based entirely on theory. Although the ISO indicated that it plans to circulate data on the costs of meeting SOL requirements under the current approach (*i.e.*, using 10 minute contingency reserves, Exceptional Dispatch, and MOC), that information obviously is not sufficient to allow a comparison of overall costs under the current approach versus a reasonable estimate of overall costs under the proposed preventive-corrective constraint approach. The ISO should not abandon the current

method of addressing SOL requirements without performing a comprehensive cost/benefit analysis (*i.e.*, one that considers not only costs under the current approach but also estimated costs under the proposed approach) based on historical market data.

Finally, the Straw Proposal does not explain how the ISO will assure that resources selected and paid for corrective capacity in fact will be available if an N-1-1 contingency event occurs. In the absence of enforceable performance requirements for corrective capacity resources, customers will receive no value at all for their capacity payments, and there will be less assurance, relative to the current approach of relying on Exceptional Dispatch and MOC, that the ISO will be able to maintain reliability. Because N-1-1 contingencies are not expected to occur frequently, the remedy for non-performance with a corrective capacity obligation must be more stringent than simply rescission of the capacity payment during a specific contingency event.

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