July 26, 2013

COMMENTS ON BEHALF OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA ON THE ENERGY IMBALANCE MARKET 2ND REVISED STRAW PROPOSAL

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 July 2, 2013 Energy Imbalance Market 2nd Revised Straw Proposal ("the 2nd Revised Straw Proposal").

Alignment of EIM Costs with Benefits - - The Six Cities continue to support ongoing exploration of the Energy Imbalance Market ("EIM") concept with the objectives of improving efficiency and enhancing reliability for all EIM participants. As the EIM concept has evolved, however, the Cities have become more, not less, concerned that implementation of the EIM by applying some but not all of the ISO's complex market features to supply imbalance energy services to other Balancing Authority Areas ("BAAs") may lead to unintended consequences and increased costs to LSEs within the ISO's BAA. In the 2nd Revised Straw Proposal, the ISO proposes to allocate certain types of costs (*e.g.*, congestion costs) to the BAA in which the costs arise. There is no reason to conclude, however, that an effort to maintain separate cost "buckets" as among BAAs will result in cost allocation that is consistent with the cost causation principle. As the ISO noted at page 22 of the matrix of previously-submitted comments and ISO responses, "EIM is a single, integrated real-time market, and resources in any area within the EIM footprint may meet needs for real-time imbalance energy of congestion management in another area within the footprint, within the available transmission capacity." Given the integrated nature of the EIM, attempting to segregate the costs resulting from EIM dispatches by BAA is not likely to result in cost allocation that is consistent with cost causation. To take one example, dispatch of a unit in one BAA may occur in whole or in part to meet the imbalance energy needs of another BAA. If such dispatch results in Bid Cost Recovery charges, it would not be consistent with the cost causation principle to impose those BCR costs entirely on the BAA in which the resource is located, which appears to be what the 2nd Revised Straw Proposal contemplates.

It is clear from the ISO's comments/response matrix that cost allocation, and particularly allocation of uplift costs, is a highly contentious issue. PacifiCorp's comments make clear that it is unwilling to take on the burden of any uplift costs that are attributable to the ISO's existing market processes. That seems fair enough, but it would be equally unreasonable to adopt a cost allocation mechanism that would expose ISO load to additional uplift costs in order to expand the scope of the ISO's imbalance services market. That would appear to be the likely consequence of the cost allocation approach included in the 2nd Revised Straw proposal.

Conceptually, the allocation of costs resulting from implementation of the EIM should track the benefits resulting from the EIM. The "costs should align with benefits" concept has been described as an alternative formulation of the cost causation principle. The Six Cities therefore urge the ISO to consider development of a robust methodology for determining EIM benefits as well as a methodology for identifying all costs arising from implementation of the EIM, including incremental uplift costs occurring in any participating BAA. The EIM costs should be allocated in proportion to the EIM benefits. Of course, if the overall costs of implementing the EIM exceed the benefits for any sustained period, the EIM should be discontinued.

Effects on Uplifts Associated With Virtual Bids - - Related to the discussion above regarding allocation of uplift costs that may be affected by implementation of the EIM, several stakeholders raised concerns that the inherent differences in the Day-Ahead Market, in which virtual bids will be submitted, and the EIM Real-Time Market, in which virtual bids would be settled, inevitably will give rise to uplift costs. The ISO cannot ignore the effects of implementing the EIM on the outcomes of the virtual bidding process. To the extent implementation of the EIM gives rise to additional uplifts associated with virtual bidding, such uplifts must be recognized as costs of the EIM that are allocated in proportion to the benefits of EIM participation. Alternatively, such uplifts reasonably could be allocated to virtual bidders. It would be patently inconsistent with the cost causation principle, however, to allocate such uplift costs to ISO load.

Flexible Capacity Requirements - - In their June 14, 2013 comments on the first Revised Straw Proposal, the Six Cities expressed concern that capacity procured by load within the ISO BAA, especially flexible capacity, could be used to support EIM Entities without appropriate compensation or reciprocal support. Comments by other stakeholders expressed similar concerns. The 2nd Revised Straw Proposal responds to this concern by including a proposal to apply a flexible capacity requirement for each BAA participating in the EIM. The objective of this requirement would be to ensure that each participating EIM Entity provides sufficient flexible capacity to meet the needs of its BAA. The Six Cities support the proposal to apply a flexible capacity requirement for each participating BAA.

Transmission Charges - - The 2nd Revised Straw Proposal maintains the ISO's recommendation that transmission for EIM dispatch, at least for an initial implementation period, not be subject to a transmission charge. A number of stakeholders have identified concerns with this proposal, including discrimination among resources participating in the EIM versus other resources and the potential that the availability of free transmission in the EIM may discourage Day-Ahead scheduling. This issue requires careful evaluation and additional analysis. At a minimum, if implementation of the EIM goes forward without transmission charges for EIM transactions, the ISO must be alert for potential market distortions and prepared to act promptly to address any that appear.

Implementation Questions - - In addition to the issues discussed above, the Six Cities have the following questions relating to implementation of the EIM:

- Although the 2nd Revised Straw Proposal makes clear that each BAA participating in the EIM will remain responsible for resolving reliability concerns within that BAA, it is not clear to the Six Cities how that obligation will be enforced. If an EIM Entity does not adequately address a reliability issue in Real-Time, how will the ISO as the Market Operator isolate the impact of that failure to the relevant BAA?

- The discussion at pages 48-49 of the 2nd Revised Straw Proposal indicates that uninstructed imbalance energy and instructed imbalance energy will be settled at the same prices. If that is the case, what incentives will resources have to follow EIM dispatch instructions?

- The 2nd Revised Straw Proposal at pages 58 and 64 discusses the anticipated process for expanding the EIM to include additional EIM entities and related recovery of EIM costs. There is no discussion, however, regarding recovery of EIM costs if an EIM Entity decides to withdraw from the EIM. What is the anticipated arrangement for recovering EIM costs in the event the EIM terminates or one or more EIM Entities choose to withdraw?

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