

October 20, 2023

Re: Updated Comments on the October 5, 2023 Supply-Side Demand Response Qualifying Capacity Working Group Discussion on Penalty Enforcement Mechanism

I. Introduction

The California Efficiency + Demand Management Council (Council) appreciates this opportunity to provide comments and high-level suggestions on the October 5 Supply-Side Demand Response (DR) Qualifying Capacity (QC) Working Group discussion on the Penalty Enforcement Mechanism (PEM) of the Incentive-Based DR QC Counting Methodology (Methodology). These reflect the Council's current thinking but we are of course open to discussing alternative approaches, especially in the context of the Methodology in aggregate.

II. Key elements

- i. Which agency/organization is responsible for administering the PEM process and determining the penalty amount?** The CPUC is the most appropriate lead entity for administering the PEM, with the assistance of the CEC as necessary, including the determination of any penalties and communication with counterparties, as applicable. The CAISO should not play this role because they have no jurisdiction over capacity market issues and it is not clear it desires to perform this function.
- ii. How would any potential penalties be assessed?**
 - DR Providers: Assuming that total penalties could not exceed total contract revenues, any penalties assessed on a DR provider could be done by derating the contract value. Such a derate notice would be provided to the DR provider and contracting LSE which would then be reflected in the LSE's payments to the DR provider. This approach avoids the need for DR providers to allocate additional collateral for each contract and avoids any concerns about sharing competitive information.
 - IOUs: Penalties for the IOUs' tariffed DR programs might best be assessed through a reduction in recoverable costs through the Annual Electric True-up

(AET), the vehicle through which DR program costs are recovered. Penalty costs should not be recoverable from ratepayers; instead, they should come from shareholder revenues in order to provide the greatest motivation for good performance. If IOUs are allowed to simply pass off any penalties to ratepayers, it is unclear that it would have any real effect on IOU DR performance. However, if the Commission chooses to allow penalty pass-through, doing so should be contingent on a Commission determination of reasonableness in a to-be-determined forum.

- iii. **When should the PEM be deployed?** The Council supports PG&E's proposal for a four-year phase-in of the penalty, as illustrated in its September 29, 2023 Comments on the Capacity Shortfall Penalty. This would involve a 0% penalty rate multiplier in the first year the penalty is applied (2025), 25% in Year 2, 50% in Year 3, and 100% in Year 4 and beyond. This phased approach will help to avoid financial shocks to IOUs and DR providers. In addition, a mechanism should be established as part of the Method proposal that the Energy Division and CEC staff conduct a check-in at the end of each of the first three years to determine whether any adjustments are necessary.
- iv. **On what capacity value (\$/kW) should the penalty be based?**
 - DR Providers: By derating the contract capacity, the \$/kW penalty will be the same as provided in the contract.
 - IOUs: For tariffed DR programs, a proxy price is needed because the IOUs do not have counterparties. The CPUC's \$8.88/kW-month Resource Adequacy penalty during the summer months and \$4.44/kW-month in the winter months would be appropriate because it is assessed for a capacity shortfall.
- v. **How would this work under Slice of Day?** This requires further discussion but penalties should not be assessed more frequently than performance is evaluated. For example, if performance is assessed quarterly then potential penalties should not be imposed more or less frequently. In turn, performance should not be evaluated more frequently than testing is required. Otherwise, the penalty mechanism would serve as

a de facto testing requirement, necessitating that DR providers dispatch their resources more often than is necessary.

- vi. What positive and negative performance buffers should be adopted?** The Council originally opposed a positive performance buffer on the basis that increasing revenues beyond a contract quantity would be highly problematic to implement. However, in light of PG&E's October 5 proposal, if applied solely for the purpose of mitigating underperformance, the Council is supportive. As a counter proposal to PG&E's 105.5%-94.5% buffer, the Council proposes a 105%-90% band. This maintains the 15% buffer the Council originally proposed (85%-100%) but modifies how it would be allocated. A 5% positive performance buffer (i.e., 100%-105%) would provide a reasonable opportunity for IOUs and DR providers to mitigate resource underperformance without motivating overperformance at such a magnitude that it would risk destabilizing local areas of the grid. Conversely, the 10% negative performance buffer (i.e., 90%-100%), being larger than the 5% positive performance buffer, would mitigate the pressure to overperform in order to avoid being penalized.
- vii. How would the penalty mechanism be applied under Slice-of-Day?** The PEM should be applied at the program- (IOU) or contract-level (IOU and DR provider) for each hourly slice to be consistent with the Slice-of-Day regime. However, performance should first be assessed at the resource-level and aggregated upward to prevent overperforming resources from canceling out underperforming resources beyond any positive performance buffer.

III. Conclusion

The Council appreciates this opportunity to provide initial comments on the PEM and looks forward to additional discussions.