Reliability Must Run and Capacity Procurement Mechanism Enhancements Second Revised Straw Proposal

Comments by Department of Market Monitoring

January 10, 2019

Overview

DMM appreciates the opportunity to comment on *the ISO's Reliability Must Run and Capacity Procurement Mechanism Enhancements Second Revised Straw Proposal* issued on December 12, 2018.[1] The Second Revised Straw Proposal includes incremental changes to the Revised Straw Proposal. Overall, the ISO's proposal includes significant incremental enhancements to the existing backstop procurement design. While the ISO's proposal is an improvement over the current structure, some key concerns remain unaddressed.

The ISO's proposal improves the current backstop procurement design by making the following changes to the CPM/RMR framework:

- Compensation above the soft offer cap is changed to a Going Forward Fixed Cost (GFFC) structure instead of using Schedule F of the Pro Forma RMR contract.
- RMR resources are subjected to a Must-Offer Obligation like RA resources.
- RMR Condition 1 is eliminated.
- The ISO will seek to limit RMR designations only to units that would retire without RMR contracts.

However, the ISO's proposal does not address the following concerns with the overall CPM/RMR framework:

- The ISO's proposed cost recovery above the soft offer cap may be excessive if a supplier can file for its actual GFFC plus 20% and also retain market revenues.
- The current soft offer cap may be too high for annual CPMs.
- When CPM solicitations are not competitive, resources can attain compensation at the soft offer cap plus retain all market revenues. This compensation may be significantly in excess of a resource's GFFC plus a reasonable return.

[1] *Reliability Must Run and Capacity Procurement Mechanism Enhancements Second Revised Straw Proposal*, California ISO, December 19, 2018. http://www.caiso.com/Documents/SecondRevisedStrawProposal-ReliabilityMustRunandCapacityProcurementMechanismEnhancements.pdf

- While the ISO will seek to limit RMR contracts for avoiding resource retirements, the current process and proposed enhancements could still allow for units that have no intention of retiring to seek RMR compensation.

The ISO states it will not address changes to the CPM pricing structure in its current initiative, but has committed to reassessing its soft offer cap in a separate stakeholder process in 2019.[2] Given the important and controversial nature of this issue, DMM encourages the ISO not to delay working on this effort with stakeholders and to keep stakeholders engaged by holding working groups to discuss potential cost studies and alternative pricing frameworks for annual CPM designations.

The ISO also states it will not subject retirement notifications to an economic test. DMM suggests that the ISO, at the very least, set the expectation that cost filings will be subject to review by the ISO and/or DMM, and that submission of misleading information or evidence of market manipulation may be referred to FERC. This type of precedent is consistent with provisions the ISO has specified for risk of retirement CPM designations.[3]

The following sections provide more detailed comments on these and other issues.

CPM compensation

DMM supports the ISOs proposal to change CPM compensation above the soft offer cap to a structure based on GFFC instead of using Schedule F of the Pro Forma RMR contract. However, the ISO's proposal still does not address some key concerns.

Cost filings above the soft offer cap

While DMM supports changing cost recovery above the soft offer cap to a structure based on GFFC, the ISO may allow for excessive recovery if a supplier can file for its actual GFFC *plus* 20% and also retain all net market revenues.

The ISO reasons that the 20% adder is justified by prior FERC direction and is necessary to allow for some contribution to additional fixed costs. However, FERC's reasoning for rejecting the ISO's 2010 soft offer cap proposal ($55/kW-year, based on a reference unit's GFFC plus a 10% adder) was that the ISO had not *demonstrated* or *explained* how the proposed methodology would provide revenue sufficiency. FERC stated:

> …we find that CAISO has failed to demonstrate that the proposed long-term, fixed price CPM, which is based on a resource's going-forward costs plus a 10 percent adder, is just and

[2] *Second Revised Straw Proposal*, p. 36.
[3] *BPM for Reliability Requirements,* Section 12.6.4.

> reasonable compensation for the capacity procured to maintain reliable operations, and find that it may be unjust and unreasonable …..[4]
>
> CAISO, in this filing, has not explained how the use of going-forward costs for CPM compensation will provide incentives or revenue sufficiency for resources to perform long-term maintenance or make improvements that may be necessary to satisfy new environmental requirements or address reliability needs associated with renewable resource integration …[5]

In its 2015 filing establishing the current soft offer cap, the ISO reasoned that $75.68/kW-year addressed the Commission's initial concerns as it included a 20% adder to a proxy resource's GFFC which could account for additional fixed costs. The ISO stated:

> Using a 20 percent adder, rather than a lower adder, will address these concerns and allow additional fixed cost recovery consistent with the CPM Order...The adder will allow return on and of capital to allow recovery of additional fixed costs. For example, the adder facilitates the costs of incremental upgrades, including upgrades to enhance flexibility and make resources more efficient, upgrades to satisfy environmental requirements, upgrades to address reliability associated with renewable integrations, and other plant modernization upgrades. [6]

FERC accepted the ISO's justification in its 2015 Order:

> In addition, we find that CAISO's proposal to implement a soft offer cap of $6.31/kW-month ($75.68/kW-year), plus a 20 percent adder should allow sufficient recovery of fixed costs plus return on capital to facilitate incremental upgrades and improvements by resources. Further, because the soft offer cap represents the high end of the range of current resource adequacy prices, it should not create incentives for load-serving entities to forego bilateral resource adequacy contracts and, instead, rely on CPM backstop procurement…[7]

Based on these filings, DMM does not believe that an adder less than 20% is inconsistent with prior FERC orders and guidance. The ISO never demonstrated that a lower adder was sufficient to contribute to any additional fixed costs or plant upgrades. Additionally, DMM reads FERC's ruling to apply to the soft offer cap, not necessarily resource-specific cost filings above the soft offer cap.

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[4] *Order on tariff revisions,* 134 FERC ¶ 61,211, Docket No. ER11-2256, March 11, 2011, P.19: https://www.ferc.gov/whats-new/comm-meet/2011/031711/E-12.pdf

[5] Id., P.20

[6] *Tariff Amendment and Offer of Settlement Regarding Capacity Procurement Mechanism Revisions and Request for Waiver of Notice Requirement,* California ISO, ER15-1783, May 26, 2015, pp. 15-21: http://www.caiso.com/Documents/May26_2015_TariffAmendment_CapacityProcurementMechanism_Revisions_ER15-1783.pdf

[7] *Order on tariff revisions*, 153 FERC ¶ 61,001, Docket No. ER15-1783, October 1, 2015, p. 14: http://www.caiso.com/Documents/Oct1_2015_OrderAcceptingTariffRevisions_CapacityProcurementMechanism_ER15-1783.pdf

DMM recommends that instead of assigning an arbitrary percentage adder to GFFC, the ISO could require suppliers seeking compensation above the soft offer cap to explicitly file for actual costs associated with long term maintenance or environmental upgrades. Moreover, net market revenues also provide a return to suppliers. If the CPM process was competitive, suppliers would be expected to bid up to GFFC *net* of projected market revenues. Instead, the ISO will allow suppliers to recover full GFFC *plus* 20% and also retain net market revenues. This may represent excessive compensation for unit with locational market power.

Soft offer cap for annual CPMs

The ISO's proposal does not address concerns that the soft offer cap for annual CPMs may be too high. The ISO justified the current soft cap approach in its 2015 filing under the premise that CPM would be *rarely used* and would typically be used for *shorter periods*, so was a simpler approach:

> The approach adopted in the Offer of Settlement recognizes that the CAISO rarely uses CPM and that, under such circumstances, a simpler approach that avoids complex market power mitigation measures and avoids litigation is a more prudent and reasonable approach….[8]
>
> This will promote efficiency and eliminate burdens associated with developing and establishing proceedings to set prices for individual resources in connection with a mechanism that is rarely used and, when used, typically only results in designations for short periods.[9]

The ISO issued annual CPMs to three resources for 2018.[10] The ISO has also expressed concern that the CPUC's *Proposed Decision Refining the RA Program* proceeding could result in increased reliance on ISO backstop procurement.[11] Thus, DMM believes it is important and timely for the ISO to reassess its soft offer cap for annual CPMs. The current soft offer cap was justified under the assumption that use of CPM would be infrequent, and even less frequent for annual CPMs. There is evidence and concern that these assumptions may no longer hold.

Competitiveness of CPM solicitations

Stakeholders have raised concerns[12] that CPM solicitations, particularly annual CPM solicitations, are not competitive as resources have cleared at or close to the soft offer cap.[13] A lack of competition – coupled with a soft offer cap that is too high for annual CPMs – raises

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[8] Id., p.17
[9] Id., p.20
[10] *December 22, 2017 Year Ahead Local CPM Designation Report*, California ISO: https://www.caiso.com/Documents/December222017YearAheadLocalCPMDesignationReport.pdf
[11] *California Independent System Operator Comments on Proposed Decision*, CPUC Rulemaking 17-09-020, December 11, 2018, p. 2.
[12] Comments on RMR and CPM Enhancements Revised Straw Proposal, SCE, October 23, 2018, p.2: http://www.caiso.com/Documents/SCEComments-ReliabilityMust-RunandCapacityProcurementMechanismEnhancements-RevisedStrawProposal.pdf
[13] *December 22, 2017 Year Ahead Local CPM Designation Report*

concern that the CPM soft offer cap for annual CPMs is not an effective form of market power mitigation.

DMM encourages the ISO to reassess its soft offer cap for annual CPMs, or alternatively, consider suggestions to apply a market power test to CPM solicitations.

While the ISO states it will not address changes to the CPM pricing structure in its current initiative, the ISO commits to reassessing the soft offer cap in a separate stakeholder process in 2019. Given the important and controversial nature of this issue, DMM encourages the ISO not to delay working on this effort with stakeholders and to keep stakeholders actively engaged by holding working groups to discuss potential cost studies and alternative pricing frameworks for annual CPM designations.

Limiting RMR to units seeking retirement

DMM supports the ISO clarifying when CPM versus RMR should be used, and its proposals to require an offer affidavit when a retirement notice is submitted to the ISO. However, because two distinct payment structures would continue exist under the ISO's proposal, it may be necessary to add additional provisions around the RMR process to ensure the RMR process is only used when a resource is legitimately seeking retirement.

Consistent with other ISO processes, resources seeking retirement which are needed for reliability could file at FERC for up to full cost-of-service under the ISO's proposal. Other ISOs, however, perform additional checks around their retirement processes to ensure only resources legitimately seeking retirement initiate this retirement process and potentially receive cost-of-service payments. In addition, as noted in prior DMM comments, other ISOs generally treat full cost-of-service as an upper bound on RMR compensation, which is ultimately determined and approved only through a filing at FERC.[14]

DMM suggests that the ISO develop more robust provisions around the RMR process similar to other ISOs. The ISO could require resources attesting retirement to submit cost information to the ISO/DMM for review. The ISO could also clarify potential consequences if it appears that a retirement decision constitutes potential physical withholding.

The criteria for filing at FERC could also include the requirement that the generator make a showing that they intend to retire and it is not economic to stay on-line absent additional RMR compensation. This might also include a showing that the unit was not economically or physically withholding from the bilateral RA process.

This framework appears more consistent with other ISOs' capacity procurement and RMR processes. Other ISO market monitors (PJM, NYISO, ISO-NE) require submission of resource costs and review resource costs to evaluate reasonableness of retirement decisions. Unit

[14] RMR CPM Enhancements Revised Straw Proposal Comments, DMM, October 23, 2018, p.8: http://www.caiso.com/Documents/DMMComments-ReliabilityMust-RunandCapacityProcurementMechanismEnhancements-RevisedStrawProposal.pdf

economics are evaluated, and the ISO or its market monitor will also assess suppliers' portfolios to protect against physical withholding.

The expectation that cost information will be reviewed by the ISO/DMM could add another check to the resource retirement process to prevent self-selection between CPM and RMR. DMM notes that this type of precedent is consistent with provisions the ISO has specified for risk of retirement CPM designations.[15]

[15] *BPM for Reliability Requirements,* Section 12.6.4.