Comments of Powerex Corp. on
Capacity Procurement Mechanism Soft Offer Cap Draft Final Proposal

Submitted by	Company	Date Submitted
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Powerex appreciates the opportunity to submit comments on CAISO's Capacity Procurement Mechanism ("CPM") Soft Offer Cap Draft Final Proposal. In the Draft Final Proposal, CAISO explains that it: (1) has decided not to make any adjustments to the level of the soft offer cap (currently $75.67-kW-yr); (2) recognizes that there may be a need to consider other options to determine a soft offer cap in the future as the grid continues to evolve; and (3) has abandoned the proposal to apply a three pivotal supplier test for 12-month CPM designations. CAISO also states that it plans to move forward with the proposal developed in a separate proceeding to change the approach for compensating resources that bid above the soft-offer cap to allow a resource to only recover their going forward fixed costs (plus a 20% adder).

At this time, Powerex does not oppose CAISO's decision not to modify the level of the soft offer cap or to make other substantive changes to the CPM framework at this time. However, Powerex encourages CAISO to continue to consider how the CPM framework can be modified to make the mechanism more effective in addressing shortfalls in the capacity procured through the Resource Adequacy ("RA") framework.

The ability of the CAISO to compete with external regions to secure forward commitments of the capacity of external resources is becoming increasingly important to the ability of CAISO to maintain reliability. In particular, it has been widely acknowledged that the resources within the CAISO balancing authority area are no longer sufficient to meet system needs. At the same time, retirements of baseload resources outside the CAISO are resulting in tightening grid conditions across the western interconnection and greater competition among load-serving entities ("LSE") in the forward markets for the limited surplus capacity that is available. These factors have created a pressing need to reevaluate the existing frameworks for procuring capacity on a forward basis to ensure that they allow CAISO to effectively compete with other regions to obtain the forward capacity commitments necessary to meet system needs.

Powerex believes that the design of the existing CPM framework needs to be strengthened in several respects in order to ensure that CAISO is able to successfully compete to obtain the forward commitment of capacity from external resources necessary to allow CAISO to effectively and efficiently meet its reliability needs. As an initial matter, the CAISO should move towards a CPM framework that requires CAISO to procure capacity, at a minimum, as a six-month seasonal product (*i.e.,* summer and winter). CAISO's existing practice of procuring backstop capacity in single month increments hampers CAISO's ability to effectively compete to obtain capacity from external resources. Importantly, LSEs outside of the CAISO are increasingly entering into seasonal, annual, or multi-year forward contracts with external resources with surplus capability in order to ensure that they are able to meet their capacity and flexibility needs. As a result, external suppliers that have surplus capability are likely to view a CPM designation as relatively unattractive when compared to the other opportunities available in the bilateral markets in the west. The result is that CAISO may not be able to obtain the capacity commitments necessary to maintain reliability. Even if surplus capability is available, it is likely that CAISO will be left to meet its backstop procurement needs with whatever residual capacity has not been committed to meet the needs of external LSEs, which is unlikely to represent the most efficient or cost-effective option available.

Additionally, the CAISO should further strengthen the CPM by procuring backstop capacity on a year-ahead basis in order to compete with LSEs in other regions that are generally seeking to acquire capacity on a seasonal basis. Procuring backstop capacity on a year-ahead basis will also provide external resources with the lead time necessary to plan their systems to meet CAISO's needs and maximize the supply options available. It is important to recognize that certain external suppliers, particularly the storage hydro systems in the Northwest, may only be in a position to meet CAISO's capacity needs with forward commitments that provide them with the certainty necessary to operate their systems in a manner to ensure that they are able to support a firm commitment to the CAISO. Waiting until the month-ahead timeframe to procure capacity means that many of these suppliers may not be in a position to provide residual capability to the CAISO, either because they have already made operational decisions that prevent them from doing so or they have already committed their surplus capability to meet the needs of other regions. Again, the result will be fewer supply options for the CAISO, creating the possibility that CAISO will be unable to maintain reliability or will be forced to meet system needs using a suboptimal mix of resources.

Powerex also believes that compensating resources that receive a CPM designation based on a monthly soft offer cap reflecting 1/12 of the annualized cost of new entry reduces the quantity of capacity voluntarily made available to meet CAISO's needs. Although Powerex is not opposed to basing the soft offer cap on the cost of new entry, the existing approach results in a capacity supplier receiving 1/12 of the annualized value of the net costs that must be recovered each year for multiple years to support new investment. In practice, providing sellers with a single month of compensation—even at a price that exceeds the existing soft offer cap—is likely to encourage sellers to commit their capacity to LSEs in external region, many of which are currently seeking to enter into year-ahead or multi-year commitments with suppliers. In other words, the continued use of a monthly compensation structure reduces the ability of CAISO to compete to obtain forward commitments of capacity from external suppliers. Powerex encourages CAISO to consider how the compensation structure for CPM designations can be modified to allow CAISO to more effectively compete with external regions to obtain forward commitments of capacity. One option that could be considered would be to apply a soft cap that limits the total annual revenues received by a supplier for forward capacity contracts with the CAISO (or California LSEs). For instance, a resource that does not have an RA commitment would be subject to a higher soft offer cap than a resource with an RA commitment for part of the year at issue.

CAISO's proposal to only permit resources that bid above the soft offer cap to recover their going-forward fixed costs (plus an adder) will further impair CAISO's ability to compete to obtain forward commitments of capacity from external regions. Given the widely acknowledged capacity shortfalls facing the CAISO, Powerex believe that the full cost of new entry, rather than going forward costs, is a more appropriate benchmark for determining the compensation for resources that receive a CPM designation and bid above the cap. As the Market Surveillance Committee ("MSC") has explained, while resources can be expected to offer their capacity at a level reflecting their going forward costs in areas with sufficient capacity, capacity payments "should be based upon either some multiple of net-CONE or if greater, net GFFC" in areas that are "capacity deficient."[1] The use of going-forward costs is also inconsistent with the approaches employed by other RTOs. As the MSC has explained, in RTOs with centralized capacity markets, the RTOs typically ensure that capacity scarcity is appropriately reflected in prices by "using capacity demand curves whereby prices rise gradually as reserve margins decline up to a price ceiling that is some specified multiple of Net CONE."[2] Similarly, in the Southwest Power Pool ("SPP"), SPP will assess LSEs that fail to meet their resource adequacy ("RA") requirements deficiency charges based on a multiple of the cost of new entry, and distribute the associated revenues to LSEs and generation resources that provide capacity to compensate for any resulting shortfall.[3] CAISO's proposal to only permit sellers that bid above the cap to recover their going forward costs, in contrast, will depress the price signals necessary to ensure that CAISO has sufficient resources available to meet reliability needs and further discourage external resources from voluntarily making their capacity available to the CAISO.

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[1] Market Surveillance Committee, Opinion on Reliability Must Run and Capacity Procurement Mechanism Enhancements at 10, 16 (Mar. 18, 2019), available at: http://www.caiso.com/Documents/MSC-Opiniononreliabilitymustrunandcapacityprocurementmechanismenhancements-Mar20_2019.pdf.

[2] *Id.* at 11.

[3] SPP, Open Access Transmission Tariff, Attachment AA, Section 14.