Comments of Calpine Corporation on

Capacity Procurement Mechanism

Draft Final Proposal

Comments Submitted: 1/23/20
By: Mark J Smith

Summary:

Given impending foundational shifts in forward procurement practices as well as supply and demand fundamentals, Calpine supports, with one exception, the CAISO's deliberate approach to CPM modifications.

CPM is intended and has heretofore been employed as a rarely used backstop and "not a forward procurement tool.[1]" In order to preserve its utilization as a backstop procurement mechanism, the CPM must balance two objectives: (1) it should allow for fixed cost recovery for units needed for reliability, and (2) it should procure capacity at a price level that retains RA as the primary procurement mechanism and discourages reliance on backstop procurement. Calpine generally believes that the Draft Final Proposal, which maintains the soft offer cap at its existing level, appropriately strikes this balance.

However, Calpine continues to disagree with the CAISO's proposal to change the maximum level of bids that can be submitted above the soft offer cap. This is the wrong solution to a widely acknowledged problem.

Calpine reiterates its 8/20/19 comprehensive comments on these matters and highlights certain of those comments here.

Level of the Soft Offer Cap:

As reflected in our earlier comments, we support the CAISO proposal to maintain the current soft-offer cap price. CEC studies have shown the costs of the reference unit have not materially changed and the CAISO correctly concludes that while new technologies are entering the market, during the transition to the State's clean energy goals, gas-fired resources will continue to be necessary. As the CAISO has concluded, leaving the soft offer cap unchanged will "not create

---

[1] Draft Final Proposal at p.8.

incentives for load serving entities to forego bilateral RA contracts and instead rely on CPM backstop procurement."[2]

At the same time, because of supply tightness, RA market prices have risen substantially since the CPM soft offer cap was established four years ago. Reducing the CPM soft-offer cap at this point could create undesirable incentives for buyers to forego RA procurement and rely instead on CAISO backstop procurement, impeding the goal of rare and uncommon use of CPM.

In addition, the CPUC is considering substantial structural reforms to forward RA procurement that will affect the need for and design of the backstop mechanism[3]. While not yet adopted by the CPUC, a central procurement entity (CPE) settlement has been filed, and is being considered at the Commission which could greatly affect the level of procurement at or on behalf of the CAISO.

Under the settlement proposal and any similar structure that might be adopted by the CPUC, the linkage between the RA and CPM programs is hard-wired. That is, the CPE would explicitly defer procurement to the CAISO when bids exceed the soft-offer cap. In addition, through its consideration of alternatives, the CPUC could modify its own assessment of deficiency penalties which currently form a strong deterrent to the use of the CAISO backstop. Any of these changes, as well as some we cannot predict, could swing the balance to unexpected, or at least unprecedented, levels of procurement by the CAISO.

In addition, there is now widespread appreciation that the supply and demand balances are tightening. The CPUC has issued procurement mandates to bring in excess of 3,000 MW of new capacity into the market in the near term. A backstop that is based on going-forward costs may not be appropriate in this changed environment. Rather a more appropriate design might incorporate investment signals such as those offered elsewhere using demand curves and a multiple of net-CONE.

Finally, in any soft offer cap filing at FERC, the CAISO should commit that should these or other structural changes to the RA program be made, a more comprehensive reconsideration of the entire CAISO backstop procurement process will need to be undertaken. The CAISO should make explicit in its FERC filing that its proposed retention of the existing soft offer cap ignores the potential impacts of structural RA changes, which, if anything, would justify a higher CPM price level than at present.

In sum, we support the CAISO's deliberate approach for the near term. The CAISO should not put the cart before the horse and attempt to design or substantially revise a backstop procurement mechanism before the structural

[2] Draft Final Proposal, p.7.

[3] We note that with the implementation of a three-year forward procurement requirement for local RA, Calpine would anticipate a diminished need for CPM, if the soft offer cap rules are retained.

reforms of the forward procurement process, and their likely market outcomes, become known.

Bids above the Soft-Offer Cap

Bids in excess of the soft offer cap submitted to the Competitive Solicitation Process are currently capped at the resource-specific full cost-of-service (as represented by Schedule F of the RMR agreement.) It bears repeating that FERC accepted this provision as resulting in just and reasonable cost recovery. In what has now been characterized as an oversight, resource owners that submit a Schedule F bid would also retain any energy margin from the operation of the unit. To the extent that this result creates a problem, the solution lies in modifying the treatment of energy margins, rather than the measure of recoverable, resource specific fixed costs.

Calpine has long held (and at one point the CAISO adopted) the view that the simplest fix to this problem is to claw-back the energy margin, just as is done with RMR contracts. This claw-back could be done *ex ante* as an estimated energy margin deduction (as part of the CSP bid) or *ex post*, as with RMR, and preserve the principle that units needed for reliability should be compensated at full cost-of service.

Unfortunately, the CAISO takes a different tack, proposing to cap resource-specific bids above the soft-offer cap based on the resource's going-forward fixed costs (plus a generic adder) and that the resource owner would be allowed to keep energy margin.

Calpine believes this modification of resource-specific bids above the soft-offer cap is unjustified. Allowing specific resources to cost justify bids up to their full fixed costs, using Schedule F, is not unjust and unreasonable and has not been shown to create adverse incentives interfering with the objectives of the Competitive Solicitation Process. To the extent existing rules also allow for recovery of energy margins, that problem is most appropriately addressed through the treatment of energy margins, not the determination of the capacity costs (and value) of a specific needed resource.

To the extent commentators question the continued use of full cost of service as the measure for resource specific bids above the soft offer cap, we point to the most recent order by FERC in the RMR docket where it affirmed that units needed for reliability and mandated to operate should be priced at the full cost-of-service.[4]

[4] 168 FERC ¶61,199, P 84 (2019).

Taken in its entirety, the CPM Competitive Solicitation Process is not truly voluntary, as resources that decline to bid in the CSP are still subject to CSP bid insertion and mandatory dispatch (and subsequent availability obligations) to meet CAISO's reliability needs under the Exceptional Dispatch provisions of the tariff.

In this context, Exceptional Dispatch gives the CAISO an uncompensated call-option on the capacity of a resource that chooses not to participate in the Competitive Solicitation Process. While some compensation would follow an actual dispatch, the unit would receive no compensation throughout the year awaiting such a dispatch. Compliance with an Exceptional Dispatch order is mandatory.

Finally, Calpine notes that allowing full cost recovery for any portion of a resource's capacity, whether for less than a full 12 month designation or for less than 100 percent of net capacity value, does not result in any over-recovery of costs and should not, therefore be a basis for denying full cost of service resource specific bids above the soft offer cap.

For all of the reasons stated in our 8/20/19 comments but not repeated here, we continue to oppose the ISO proposal to cap resource specific bids above the soft cap based on, or at, going forward fixed costs.