

**DC Energy, Comments on Congestion Revenue Rights Auction (CRR) Auction Efficiency Track
1B Straw Proposal**

Submitted by	Company	Date Submitted
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DC Energy appreciates the opportunity to provide comments on the CAISO’s Congestion Revenue Right (CRR) Auction Efficiency Straw Proposal for Track 1B published on April 19, 2018. The CAISO’s proposal is focused on assigning CRR revenue inadequacy to holders of CRRs. CRR revenue inadequacy exists due to the sold quantity of CRRs being higher than congestion funding in the day-ahead market. Our recommendation is to adopt the New York ISO (“NYISO”) model for constraint level allocation of shortfall to Participating Transmission Owners (“PTOs”). This approach is consistent with cost allocation principles and provides meaningful incentives to address the root cause of shortfall. Due to its longer-term implementation horizon, we also provide our position on the various elements of the CAISO’s near-term proposal to allocate shortfall to CRR holders. Our comments are consistent with the CAISO’s stated goal of preserving equitability,¹ and, furthermore, we believe our suggested approach preserves fair access to the transmission system, recognizes the value of hedging, and helps ensure a level playing field for competition.

I. The CAISO’s proposal to allocate CRR revenue inadequacy to CRR holders by constraint is an important step toward aligning the assignment of revenue inadequacy to responsible parties

At the April 10th, 2018 CRR Auction Efficiency Working Group DC Energy presented its recommendation for the assignment CRR revenue inadequacy. It was based on the NYISO’s policy, which assigns shortfall at the constraint level to the PTOs responsible for the outages that cause CRR shortfall.² Planned transmission outage schedules play an important role in ensuring the CRR market is revenue adequate, which is why the CAISO tariff includes outage submission requirements for PTOs.³ Despite the requirement, transmission outage submission practices do not conform to the tariff and continue to be a major source of CRR revenue inadequacy.

“For outages subject to the 30-day submission requirement, about 57 percent of these outages were not submitted to the ISO in time. PG&E, SCE and SDG&E outages subject to the 30-day submission window were not received in time in about 50 percent, 65 percent and 70 percent of the time, respectively”⁴

¹ CAISO Track 1B Straw Proposal at page 5

² For more details please see DC Energy’s presentation: <http://www.aiso.com/Documents/Presentation-SethCochranDCEnergyPart2-Apr102018.pdf>

³ CAISO CRR Auction Analysis Report at page 45 and CAISO tariff section 36.4

⁴ CAISO CRR Auction Analysis Report at page at page 8

“ Through this detailed analysis, one common finding arose that leads to late or missed outages and constraints in the CRR auctions being the primary driver for revenue shortfalls and large net CRR payments to auction CRRs. In some cases, like January 2017, one single constraint missed being modelled in the annual and monthly auctions and as a result drove over 80 percent of the revenue shortfall and accounted for a significant portion of the large payout to auction CRR holders.”⁵

This poor performance is a natural consequence of not having meaningful incentives to follow the outage submission requirements. Therefore, the most viable path to improve revenue inadequacy is to address the incentive issue by allocating CRR shortfall to responsible PTOs, as is the practice in the NYISO. DC Energy’s recommendation is especially compelling in that it would preserve the value of the hedge. We understand this option might involve a longer implementation schedule than the CAISO’s current timeline for Track 1B and for this reason we provide this as our long-term recommendation to be considered with the other more complex shortfall allocation proposals reserved for Track 2. The foundation of the NYISO policy is rooted in a ‘by constraint’ approach and we view Track 1B as a building block to our recommendation. We request that the ISO explicitly include this option for Track 2 or, at a minimum, explain why it should not be considered in light of its compelling benefits.

The rest of our comments focus on the CAISO’s proposal to allocated CRR shortfall to CRR holders under Track 1B and then return to proposals reserved for Track 2.

II. There are numerous decision points within the CAISO’s proposed framework to assign CRR revenue inadequacy ‘by constraint and by hour’ to CRR holders. DC Energy agrees with the ISO that the guiding principles should be based on equitability.⁶ In the following subsections we submit our recommendations for Track 1B with the overarching goal of maintaining fairness and a level playing field for competition:

a) We agree with the ISO that constraint-by-constraint is the best approach as compared to more socialized methods of allocating CRR shortfall: This approach would mean CRR flow contributions on oversold elements would be assigned directly to the holders of those CRRs. Under the umbrella of proposals to allocate shortfall to CRR holders, this seems to be the best strategy because the holders of CRRs with flows contributing to an oversold element should be in the best position to manage the risks of their hedge becoming partially paid.

⁵ CAISO CRR Auction Analysis Report at page at page 9

⁶ CAISO Track 1B Straw Proposal at page 5

- b) **In regards to equitable treatment, it is an utmost priority to treat all CRRs equally whether received in the auction or allocation process:** We agree with the CAISO that equitable treatment is an important guiding principle in shortfall allocation design. The primary consideration is that *ALL* CRRs are treated equally and there are no special carve-outs. On the April 23 CRR Auction Efficiency web conference there were calls to provide preferential treatment to allocated CRRs by protecting them from CRR deration. These endeavors are really pleas to create winners-and-losers through inequitable market policy. If the CAISO exempted allocated CRRs from deration, it would leave the subset of market participants holding auctioned CRRs to bear the costs of shortfall. Ultimately, this would result in two separate classes of outstanding CRRs with different values based on different levels of funding certainty. These type of special carve outs will not only perpetuate the current state of transmission outage submission deficiencies, but also glaringly disrupt the goal of equitability by propping up one group of market participants at the expense of others.
- c) **Constraint level allocation of shortfall should consider the flow impacts of all CRRs held by an individual CRR holder:** When assessing a CRR participant's share of flow contribution on an oversold element, it is important to account for flow in terms of both prevailing direction and counterflows. In this way, the actual flow contribution on the oversold element is considered in the pro-rata share allocation of the deration.
- d) **CRR surpluses and deficiencies should be allocated under the principle of symmetry:** By definition a constraint level allocation of shortfall to CRR holders would directly assign all CRR shortfall. Therefore, at the end of any given period there can only be surplus congestion funding. Naturally, the question about what to do with the surplus arises. In order to maintain symmetry with the constraint level deration, any constraint level surplus should be allocated back to those who were short paid on that constraint. After this allocation, any residual surplus should be allocated to CRR holders since they bore the risk of partial payment. For example, in PJM's Financial Transmission Right ("FTR") market any congestion funding surplus is used to make-whole short paid FTRs in that month. Thereafter, any remaining surplus is carried over to fund future month short pays within the planning period and any surplus at the very end of the planning period is distributed to CRR holders. This allocation policy was implemented in recognition of the principle of risk symmetry. In other words, those who shoulder the risk of partial payments should commensurately benefit from any residual surplus.

III. *In Track 1B the CAISO proposed to reduce the level of capacity auctioned in the CRR processes as a fallback to their current proposal to allocate shortfall to CRR holders. DC Energy notes while this proposal would help with CRR infeasibility going into the monthly auctions, it is not the best way to resolve the issue*

The CAISO proposed to lower the CRR capacity in the annual process to 65%. Obviously, this would help alleviate limit expansions in the monthly auction, which inevitably lead to CRR revenue inadequacy. That said, this reduction comes with a tradeoff of less capacity being offered for long term hedges in the annual process. This is clearly not the best way to address the tradeoff issue that the CAISO is facing. CRR balancing auctions are conducted in the PJM, MISO, and NYISO markets, and under this framework, auction capacity could be released on a more graduated scale and at more frequent intervals. This helps address the dilemma as the proposition of less hedges vs. reduced revenue inadequacy is not as stark. In this way, the proposal provides a unique opportunity to strike the right balance between the two objectives. In addition, it would help rationalize CRR clearing prices since all market participants would benefit from more up-to-date pricing and constraint information. Lastly, the more frequent price discovery could be utilized in the CAISO credit requirements by using the mark-to-market of CRR positions. DC Energy recognizes that this proposal would take more time to implement than is afforded under track 1B, but we urge the CAISO to consider this as part of the Track 2 CRR proposals.

IV. *The CAISO's Track 2 proposal to perform ex ante derates based on CRR clearing prices is a flawed approach to CRR deration*

DC Energy does not support the proposal to derate based on CRR clearing prices. That is, higher prices are last in line for deration. This concept is rooted in the fallacy that low price CRRs are a sub-class of CRRs associated with high payouts and therefore should be placed first in line for derates. Furthermore, there is a misplaced belief that this policy would lower auction revenue shortfall as the CAISO speculates that this policy would force higher clearing prices on lower price CRRs.⁷ Not only is this another flawed example of the CAISO speculating on policy outcomes, it also represents another unnecessary infringement on market competition. Furthermore, this is largely overlapping policy with the delivery pair restrictions that is pending before FERC⁸, which highlights the flaws of the CAISO's piecemeal approach to CRR policy. Given this proposal is being reserved for Track 2 we will refrain from providing a full critique of this proposal.

Lastly, we submit the proposed ex-ante approach to deration is separable from the clearing price deration mechanics and it is unclear why the CAISO packaged them together in its Straw Proposal. DC Energy requests the ISO separate the proposals or at least explain why they must be packaged. As to the merits of this proposal, we again wish to reserve comment until the Track 2 initiative begins.

V. *DC Energy strongly supports the CAISO decision to not propose options that would eliminate CRR auctions as we know them. The record of our opposition to these*

⁷ CAISO Track 1B Straw Proposal at 32

⁸ Docket No. ER18-1344-000.

proposals is well established⁹ and we agree it is now time move away from them and preserve the benefits of open access, competition, and liquid hedging options.

⁹ DC Energy presentation at the April 10th CRR WG meeting: <http://www.caiso.com/Documents/Presentation-SethCochranDCEnergyPart1-Apr102018.pdf> and comments to the CRR Working Group: <http://www.caiso.com/Documents/DCEnergyComments-CRR Auction Analysis Report Working Group.pdf>