Stakeholder Comments Template

Capacity Procurement Mechanism Soft-Offer Cap

This template has been created for submission of stakeholder comments on Capacity Procurement Mechanism (CPM) Soft-Offer Cap that was published on May 30, 2019*.* The paper, Stakeholder meeting presentation, and other information related to this initiative may be found on the initiative webpage at: http://www.caiso.com/informed/Pages/StakeholderProcesses/CapacityProcurementMechanismSoft-OfferCap.aspx

Upon completion of this template, please submit it to initiativecomments@caiso.com. Submissions are requested by close of business on July 1, 2019.

Submitted by	Organization	Date Submitted
Joseph Greco	*Middle River Power, LLC.*	*July 1, 2019*

Please provide your organization's comments on the following issues and questions.

1. **Updating the soft offer cap**

Please provide your organization's feedback on the update soft-offer cap topic as described in section 4.1 of the issue paper. Please explain your rationale and include examples if applicable.

Please indicate any analysis and data review that your organization believes would be helpful to review on this topic. Please provide details and explain your rationale for the type of data and analysis that you suggest.

Middle River Power ("MRP") appreciates the need to review and potentially update the soft-offer cap as outlined in section 43A.4.1.1.2 of the CAISO tariff. Since the soft-offer cap was initially set there have been significant changes in the RA market and the California Public Utility Commission (CPUC) RA program. These changes include drastically increased scarcity in the RA market with corresponding RA price increases, a multi-year year procurement requirement for local resources, and a push to create a central procurement entity ("CPE"). MRP believes that these changes necessitate the evaluation of the intended purpose of the CPM, the soft offer bid cap, and the overall relationship between backstop capacity and the evolving RA program.

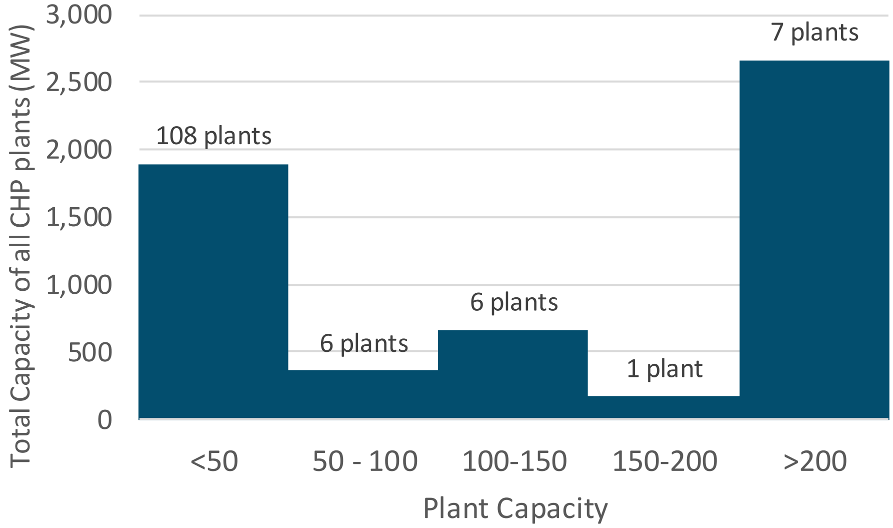
In particular, the acceleration of thermal retirements, dramatic growth of intermittent renewables, and the framing of energy storage as the primary new entrant to solve capacity shortfalls have fundamentally changed the market; participants and the CAISO should consider the appropriate "backstop price" for RA. MRP strongly believes the underlying rationale and methodology for developing the soft offer cap should be examined and modified to reflect appropriate costs to sustain existing projects and / or incentivize new technologies without discriminating against needed existing assets.

Additionally, adding to the complexity of this initiative, the soft offer cap is no longer being used solely within CAISO processes. The cap is being proposed to have multiple uses (such as a price cap for a newly created CPE) beyond just CAISO backstop evaluations. Accordingly, the soft offer cap may need to reflect not only the cost to keep the next marginal unit from retiring, but also allow for the next storage project to be procured. Failure to do so may create unintended consequences, reduce bilateral procurement, exacerbate an already tightening RA market, and / or increase of out-of-market backstop procurement.

The CPM and related soft offer bid cap were initially created to provide backstop procurement of resources required for reliability, and the CAISO established a price that allowed for the required resource to recuperate its fixed expenses over a maximum one-year period. With the creation of a multi-year procurement process, as well as several proposals under consideration by the CPUC and the Legislature for a CPE, the RA market is progressing to a longer-term forward procurement model. The cleanest and most efficient units should sustain reliability and compete in the market, while the less efficient resources become the marginal units. As a result, the soft offer bid cap should be focused on keeping the last required existing operating assets to sustain reliability and to incent new market entrants to participate. Thus, the CAISO must appropriately modify the soft offer bid cap to reflect pricing in a forward procurement paradigm, with attention to the class of resource likely to be procured as a marginal unit for reliability.

New marginal unit

The current soft offer cap has been set based on the Going Forward Fixed Costs ("GFFC") plus 20% for a new 550 MW combined cycle gas turbine resource ("CCGT"). The GFFC includes insurance, ad valorem and fixed O&M. The fundamental flaw with this approach is that a new 550 MW unit or the newly proposed 700 MW unit is not the marginal unit that will be required by the system for reliability. Based on the significant contract expirations coming over the next 2 – 3 years, the marginal unit will most likely be a small (less than 60 MW) Combined Heat and Power ("CHP") unit. These units will have higher fixed costs on a $/MW basis, and these costs should set the soft offer cap. Furthermore, 1,400MW of these marginal resources will come off long-term contracts by 2021 (see figure and details below, with CAISO plant data from SNL), further exasperating the need for an efficient reliability market and backstop procurement mechanism.



19 plants with over 1,400 MW coming off contract by the end of 2022

- 2 plants over 300 MWs
- 16 plants (~800 MW) of 100 MW or less

The CAISO should also consider where the proposed soft-offer cap price is relative to the RA market. It would be detrimental to reliability and the RA market if the backstop soft offer cap was significantly below the clearing price. Such a price construct would incent load serving entities to use the backstop mechanism rather than procure capacity resources in advance through the RA market, resulting in the CAISO backstop procurement mechanism acting as the primary capacity market in the state. This is a concern given the current tight RA conditions being experienced in California and across the West.

Recently, the CPUC acknowledged in rulemaking 16-02-007 that 100% of existing resources, after known additions and retirements, are required to maintain system reliability. Reliance on imports will continue to be challenged as coal retirements across the region force states to utilize their own in-state resources. As a result, a robust forward RA market, which includes flex, system, and local capacity products, is clearly necessary to assure needed assets stay financially viable.

Additionally, the CPUC is considering using the soft offer bid cap in the multi-year RA procurement mechanism. The proposed framework would not permit a CPE to procure RA above the CPM soft offer bid cap. If bid prices were received above the soft-offer cap, which given the current market supply and demand balance they likely will be, this will force suppliers and load serving entities into the CAISO backstop procurement market. MRP believes that the overall RA market may be negatively impacted if the CAISO sets a soft offer cap at a level that would prohibit the procurement of capacity that may be priced above a soft offer cap based on going-forward costs for a combined cycle. As additional RA procurement will occur over the next several years, the cost of the required resources could be above the soft offer bid cap due to differences in technology costs or simply due to changes in capital, financing costs, taxes, or inflation rates, leading to the early retirement of uneconomic assets that are otherwise necessary to maintain grid reliability.

For the reasons noted above, MRP encourages the CAISO to reconsider the soft offer cap formulation as they are considering a change to the current $75.67/kw-year price. The CAISO should consider an independent study which evaluates the full cost of the marginal system capacity resources in California. It is clear new capacity resources will be required to maintain system reliability and the true cost of new entry should be considered when developing the soft offer cap. The results of this analysis will be used to develop a soft offer cap and capacity market to incent development while appropriately managing system needs. Setting an appropriate soft offer cap will avoid CPM backstop procurement and allow the market to work as designed.

In a fully functional short- and long-term capacity market, new build battery energy storage costs would act as a floor for the soft offer cap. Battery storage projects are proposed to balance the system. The cost of capacity analysis should consider a detailed cost analysis for the full cost development of various energy storage options (4, 6, and 10-hour units at a minimum should be evaluated) as the next marginal unit to enter the market. Energy storage is the likely new market entrant to meet RA requirements as ELCC values continue to decrease for solar and wind resources. The findings of the CEC Staff Report, “Estimated Cost of New Utility-Scale Generation in California: 2018 Update” (Staff Report, May 2019) do not include energy storage and so MRP believes the CAISO will have to look elsewhere to determine these costs. The CAISO should factor in the full capital and on-going operating costs for these units as a floor for the soft offer cap, in order to fully account for the cost to develop, finance, and deploy the capacity needed to maintain reliability of the system.

2. Assessing payment for 12-month CPM designations

Please provide your organization’s feedback on the 12-month CPM designation payment assessment topic as described in 4.2 of the issue paper. Please explain your rationale and include examples if applicable.

Please indicate any analysis and data review that your organization believes would be helpful to review on this topic. Please provide details and explain your rationale for the type of data and analysis that you suggest.

CAISO suggests that various stakeholders are questioning the competitiveness of the CPM process and the potential for resources to exert market power. MRP would like to push back on the idea that the CAISO should evaluate the possibility to exert market power in a backstop market similar to how they would in an energy market or even capacity market. Backstop procurement by nature is unpredictable, rare, and non-transparent. Participation in the backstop market also requires removing capacity from the forward procurement market. It appears that stakeholders are conjecturing that a resource would willingly give up a bilateral contract for the potential of going to the backstop market and exerting market power – and that this is a reason to either lower the soft offer price or conduct a three-pivotal supplier test.

MRP would like to strongly push back on this idea. No rational supplier of capacity is going to turn down a capacity contract in the bilateral market with the hopes of being able to exert additional rents from LSEs in the backstop market. First, the CAISO is under no obligation to procure backstop capacity and has demonstrated over the years that in certain circumstances it is perfectly willing to go into a month (or year) “short.” Second, resource owners have a strong preference for yearly and multi-year contracts. The idea that a resource owner would intentionally carve out a month or turn down a long-term contract for the potential of only slightly increasing profits in a single month is extremely unlikely. Third, as discussed below, the soft offer cap itself is a mechanism to prevent the exertion of market power.

MRP questions the need for an additional analysis since the soft offer bid cap is a means to mitigate resources from exercising market power. If appropriately set, there is no need for a 3 pivotal supplier test. Further, the consideration of a CPE to further support RA capacity procurement using a residual procurement process will enhance competitive procurement. The overall goal should be to set a soft offer cap at a sufficient level to avoid CPM procurement by ensuring resources can be procured through the bilateral process.

Setting the soft offer bid cap at a sufficiently high, economic level will allow new market entrants to competitively bid in a resource-scarce market. The current 3-year bilateral procurement market allows new resources to bid into LSE RFO processes to avoid market power concerns. As new capacity enters the market, any potential to exert market power should no longer be a concern.

3. CPM bids above the soft-offer cap

Please provide your organization’s feedback on the CPM bids above the soft-offer cap topic as described in 4.3 of the issue paper. Please explain your rationale and include examples if applicable.

Please indicate any analysis and data review that your organization believes would be helpful to review on this topic. Please provide details and explain your rationale for the type of data and analysis that you suggest.

MRP supports a competitive CPM process and suggests that developing a soft offer bid cap that represents the cost of the next marginal unit into the system will help minimize projects bidding above the cap, while enhancing market competitiveness. In the event a resource bid exceeds the soft offer cap, MRP agrees that bid should be evaluated, and the cost justified.

Additional comments

Please offer any other feedback your organization would like to provide on the issue paper for the CPM Soft-Offer Cap issue paper.

MRP would like the CAISO to clarify that the proposal is for the annual soft offer bid cap to be the governing cap for periods throughout the year, as discussed in the recent stakeholder call. Since RA capacity requirements vary throughout the year, pricing may change to assure a facility remains viable if only providing RA for a specific period. For example, if the CAISO determines a CPM designation for a resource is required for Q3 in a particular area, the assessment of the bid should be compared to the annual cap not the monthly price cap, in order to determine if the bid is acceptable. The nature of the operations and maintenance of a large generating facility necessitates a given level of regular expenditure throughout the year to ensure reliability and availability of a resource during a given period. As such, the annual revenue requirement of a facility must be met, regardless of whether the procurement period is the full year or a portion of the year.