California ISO

Stakeholder Comments Template

Capacity Procurement Mechanism Soft Offer Cap Initiative

Draft Final Proposal

This template has been created for submission of comments on the draft final proposal issued for the Capacity Procurement Mechanism Soft Offer Cap (CPM SOC) initiative, which is available on the initiative webpage at: http://www.caiso.com/StakeholderProcesses/Capacity-procurement-mechanism-soft-offer-cap.

Upon completion of this template, please submit it to initiativecomments@caiso.com.

Submissions are requested by close of business on January 23, 2020.

Submitted by	Organization	Date Submitted
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1. Please provide your organization's overall position on the draft final proposal for this initiative. Select from options below and explain position.

Please double click on check box below to select your position:

☐ Support

☐ Support with caveats

☒ Oppose

☐ Undecided

Explain position:

PG&E appreciates the time and effort the CAISO has put into this stakeholder initiative. PG&E was highly supportive of the direction this initiative was taking with the Straw Proposal.[1] The Draft Final Proposal is a large divergence from the Straw Proposal. As expressed on the stakeholder phone call,[2] PG&E believes it is premature to label the

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[1] CAISO CPM Soft Offer Cap Straw Proposal. Accessible here: http://www.caiso.com/InitiativeDocuments/StrawProposal- CapacityProcurementMechanismSoftOfferCap.pdf

[2] 1/9/2020 web meeting: Capacity Procurement Mechanism Soft Offer Cap. Presentation available here: http://www.caiso.com/InitiativeDocuments/Agenda-Presentation-CapacityProcurementMechanismSoftOfferCap.pdf

CAISO's current proposal as *Draft Final*. PG&E does not support this Draft Final Proposal.

1. **CAISO should assure market power in the CPM is adequately mitigated.**

The evidence is clear: the "Competitive" Solicitation Process (CSP) is not always competitive. While FERC did accept the current Soft Offer Cap, CSP, and CPM as just and reasonable, the evidence collected since implementation of these processes do not yield competitive outcomes[3] and FERC has found this to be true in it recent Markets-Based Rates order.[4] PG&E believes changes are required to ensure competitive and fair prices in backstop procurement. Specifically, PG&E believes CAISO should

(i) account for market revenues when calculating the Soft Offer Cap and unit-specific going-forward fixed cost, and

(ii) Employ a market power mitigation for annual solicitations

These are the changes that PG&E would like to see in order to support this initiative.

2. **Competitive Solicitations are generally not competitive and CPM market-power mitigation is needed to protect customers.**

PG&E would like to take a step back and remind the CAISO that the cost of buying backstop capacity *via* the Capacity Procurement Mechanism (CPM) is not trivial (*see* Table 1 below[5]). Secondly 87% of the CPM capacity has been procured at or near the Soft Offer Cap.[6] This suggests that a majority of the backstop solicitations *via* the Competitive Solicitation Process (CSP) likely are not competitive. This view is supported by the DMM's own analysis[7] and the CAISO's Straw Proposal in this initiative where the CAISO says

> "CPM designations in local capacity areas can be more challenging given specific resources may be needed to reliably operate the grid in that particular area. If such a designation is necessary, the ISO may face a situation where only a few resources, or potentially a single resource, can satisfy the constraint. Because a small number of resources may have the

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[3] *See* (i) CPM designation data, *Infra* n.5; (ii) 87% of CPM capacity is procure at or near the Soft Offer Cap, *infra* n.6; (iii) CAISO's DMM analysis, *infra* n.7

[4] FERC Order 861 (168 FERC ¶ 61,040) paragraph 40. Accessible here: https://www.ferc.gov/whats-new/comm-meet/2019/071819/E-2.pdf

[5] Based on the 2019 CAISO CPM designation reports and the 2018 CPUC RA Report, section 3.3: *CAISO Out of Market Procurement – CPM Designations*. Accessible here: https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/Utilities_and_Industries/Energy/Energy_Programs/Electric_Power_Procurement_and_Generation/Procurement_and_RA/RA/2018%20RA%20Report%20rev.pdf

[6] The percentage of the purchased CPM kW-months that was above $6/kW-Month. 97% of the kW-months were perchased over $6 when the solicitation for October 2018 is excluded. For the complete set, the result is that 87% of the CPM capacity has been procured at, or near, the Soft Offer Cap.

[7] CAISO DMM's *2018 Annual Report on Market Issues and Performance*, page 266, "DMM's own review indicates that recent monthly solicitations in fall 2018 were not structurally competitive." Available here: http://www.caiso.com/Documents/2018AnnualReportonMarketIssuesandPerformance.pdf

> potential and effectiveness needed to reliably operate the grid in that area, there may be no additional bids in the competitive solicitation process that can meet the need and the available resource would be designated at any bid price. This would effectively give the resource market power for its capacity."[8]

As an Regional Transmission Operator and Independent System Operator, the CAISO has a responsibility to ensure just and reasonable rates. Ensuring just and reasonable rates requires the CAISO to mitigate against market participant exercising market power for the products the CAISO sells. PG&E believes there is sufficient evidence to show that many of the backstop solicitations are not competitive and therefore CAISO has the responsibility to mitigate against market participants exercising market power in the CSP and CPM.

Table 1: A summary of Capacity Procurement Mechanism costs, by year, from 2012-2019.

Year	Annual	Monthly	Grand Total
2012		$24,043,852	$24,043,852
2013		$2,729,457	$2,729,457
2014		$8,009,183	$8,009,183
2015		$888,055	$888,055
2016		$6,641,604	$6,641,604
2017		$8,771,763	$8,771,763
2018	$111,618,002	$15,857,271	$127,475,273
2019		$2,022,418	$127,475,273
Grand Total	$111,618,002	$68,963,603	180,581,605

Finally, the CAISO makes reference to a significant transition period in the Resource Adequacy market as the fleet changes and the CPUC implements a central buyer.[9] If this is the case, that California's RA market is about to undergo a large transition, then PG&E would argue that now is the time to implement consumer protections.

3. **CAISO cannot ignore the CPM's role in the greater California RA framework.**

PG&E recognizes that the CAISO does not have jurisdiction nor responsibility for the entire California Resource Adequacy program. However, the CAISO cannot ignore that the CSP and CPM are an integral part of the wholistic California RA program in mitigating market power in the bilateral market. If specific units are required for reliability, CAISO's

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8 CAISO Straw Proposal at page 6, *Supra* n.1

9 See the Draft Final Proposal page 7.

backstop mechanism (at reasonable costs) is essentially in curbing potential market power in the bilateral processes.

4. **Cost of Service is the highest appropriate compensation for backstop procurement of a unit that can exert market power in the CSP and CPM**

In our discussions with the CAISO and stakeholders, a key question is what should a unit be paid if it is needed for backstop procurement and has the ability to exercise market power in the CSP and CPM. Some suggest that allowing the unit to collect rents above the unit's cost-of-service is appropriate. PG&E disagrees. FERC has ruled that, for reliability services, cost-of-service compensation is an upper bound for compensation with a lower bound being recovery of the units going-forward costs.[10] If insufficient competition exists to discipline the prices offered, CAISO has the responsibility to ensure prices in their market remain reasonable (*i.e.*, not above a cost of service rate.)

PG&E's models the costs and revenues for a sample of existing gas plants of varying age and heat rates (see Figure 1 below). The results of this preliminary analysis show that many of existing units may earn significantly higher through CPM than their cost-of-service. The results in Figure 1 suggest that there are significant profits above cost of service to be made by selling at the cap in the CSP and CPM.

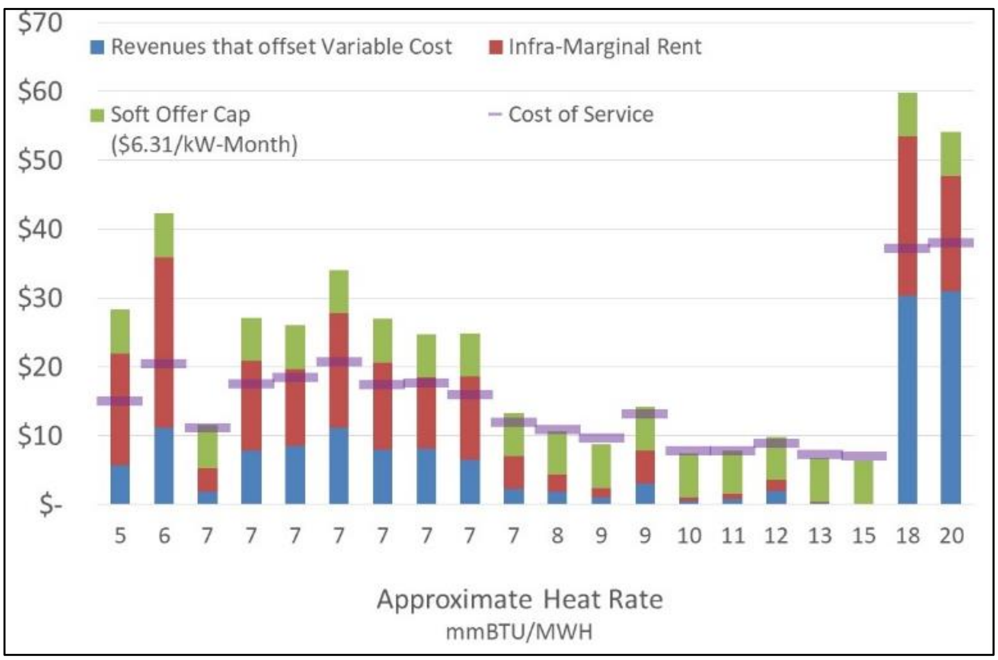

Figure 1. Estimates of CPM compensation and cost-of-service for existing natural gas plants. Total CPM revenues are represented by the stacked bar chart: energy market revenues that cover variable costs; infra-marginal rent from energy market revenues; and capacity price at the Soft Offer Cap of $6.31/kW-Month. The cost-of-service is modeled using standard regulatory accounting methods and includes cost of capital and equity. Many of the units' CPM compensation is greater than their cost-of-service and suggests that there is significant profits to be made by exerting market power in the CSP and CPM.

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[10] PJM Interconnection, LLC, 107 FERC ¶ 61,112, at P 40 (2004) and New York Independent System Operator, Inc, 150 FERC ¶ 61,116 (2015) at paragraph 17.

Cost-of-service is an upper bound for a just and reasonable compensation for backstop procurement of a unit with market power.

5. **The Straw Proposal had broad support and included a reasonable solution.**

The CAISO's Straw Proposal had broad stakeholder support and included a reasonable solution**:**

- For annual CSPs are competitive, PG&E supports the current pay-as-bid CPM compensation
- For annual CSPs that are not competitive, the designee would be paid a more administratively set price equivalent to *cost of service*.

The Straw Proposal suggested that the mitigated compensation be the unit's actual cost of service using Sch. F of Appendix G of the RMR tariff. CAISO now objects to using this schedule for mitigated CPM compensation as it would "blur the line between RMR and CPM procurement by making CPM designations more like RMR, which the CAISO deliberately sought to avoid in the RMR-CPM enhancements initiative."[11]

CAISO should have brought this to stakeholders and allowed for constructive conversations before proceeding to a Draft Final Proposal. PG&E has a solution for this problem: for non-competitive solicitations, designees could be compensated at their mitigated price plus market revenues. The mitigated price, as envisioned by PG&E's suggested method,[12] results in the expected revenues from that compensation being equal to the expected compensation under cost-of-service.

Such a solution preserves the division between CPM and RMR, pays the unit a just and reasonable rate (the expected revenues are equal to cost of service), and provides mitigation of market power in the CSP and CPM.

6. **CAISO risks FERC intervention if the CAISO does not implement further mitigation of market power in its backstop procurement.**

FERC has ruled that the current CPM is insufficient to mitigate market power without additional tests and mitigation methods. FERC notes that "the soft offer cap …does not address concerns regarding local market power. Although the soft offer cap is helpful, it does not provide mitigation comparable to the mitigation applied in the RTO/ISO administered capacity markets."[13]

As the order stands, FERC's ruling is could pose a significant burden on RA sellers through cost-based rates or other mitigation measures layered on top of the rules CAISO

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[11] Draft Final Proposal at page 9.

[12] In Appendix A of PG&E's Straw Proposal Comments, PG&E suggested a method for calculating a bid cap or mitigated capacity price for units that fail the three-pivotal supplier test. Accessible here: http://www.caiso.com/InitiativeDocuments/PG-EComments-CapacityProcurementMechanismSoftOfferCap-StrawProposal.pdf

[13] FERC Order 861, *Supra* n.4

and the CPUC apply. Additionally, CAISO runs the risk that FERC intervenes in CAISO's market design, *via* a 206 filing, and imposes FERC's own solution. PG&E would urge CAISO to avoid these pitfalls and implement its own form of market power mitigation within CPM.

7. **If the Soft Offer Cap is the only form of market power mitigation in the CSP and CPM, then CAISO needs to further justify that value.**

PG&E remains concerned about capacity market power and today, the Soft Offer Cap is the only form of mitigation against a unit exercising market power.[14] If the Soft Offer Cap is the only form of capacity market power mitigation, then CAISO needs to further justify that $6.31/kW-month is the appropriate value, especially in light of evidence that many the CSPs are not competitive and answer how that value accounts for the unit's expected market revenues.

The DMM's analysis suggests that the Soft Offer Cap should be between $23 and $31/kW-month based on the going-forward fixed cost of a large (~550-700MW) combined cycle unit.[15] This is roughly half of what the CEC study reports.[16] PG&E finds this analysis thorough and compelling. This is a wide discrepancy that should not be shelved without a meaningful discussion. On the 1/9/2020 stakeholder call, CAISO staff suggest that they had done analysis and evaluation of the DMM's analysis but did not provide any details.

CAISO should elaborate on where it differs in opinion with the DMM and show stakeholders its own analysis. If the Soft Offer Cap is the only form of capacity market power mitigation, then CAISO needs to further justify that value.

One argument CAISO presents in favor of the current value is that FERC has previously approved the value as $6.31/kW-month. This argument is no longer valid given the evidence that the CPM does not often yield competitive outcomes, that the Soft Offer Cap is insufficient in mitigating market power in the CSPs, and FERC has found this to be true in it recent Markets-Based Rates order.[17] Based on this evidence, it is not just and reasonable to continue with the current CPM structure without changes to ensure competitive and fair prices in backstop procurement including:

(i) accounting for market revenues when calculating the Soft Offer Cap and unit-specific going-forward fixed cost, and

(ii) a market power mitigation for annual solicitations

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[14] CAISO Issues Paper at page 5, "Market power mitigation for the competitive solicitation process is provided through a soft offer cap". Available here: http://www.caiso.com/InitiativeDocuments/IssuePaper-CapacityProcurementMechanismSoft-OfferCap.pdf

[15] DMM's Supplemental Comments form 9/11/2019. Accessible here: http://www.caiso.com/InitiativeDocuments/DMMSupplementalComments-CapacityProcurementMechanismSoftOfferCap-StrawProposal.pdf

[16] Estimated Cost of New Renewable and Fossil Generation in California, California Energy Commission, March 2015, Available here: https://www.energy.ca.gov/2014publications/CEC-200-2014-003/CEC-200-2014-003-SF.pdf.

[17] Previously cited, *infra* n.3,4,5,6, and 7.

Additional Comments:

8. **PG&E does not support the inclusion of the 20% adder for CPM designees filing above the Soft Offer Cap.**

PG&E's understanding of the origin of this adder is that it expanded the "safe harbor" range of the Soft Offer Cap to reduce the frequency at which units had to file at FERC. This logic does not extend to units filing above the Soft Offer Cap. These units, under the secondary proposal, would receive a unit-specific going-forward fixed cost plus market revenues. The expected cumulative revenues should be equivalent to the units cost of service without the 20% adder. Cost of service is a just and reasonable compensation for any unit. Including the 20% adder in an inappropriate wealth transfer from consumers to generators and in not just and reasonable. Therefore, PG&E does not support the inclusion of the 20% adder in the compensation of units that are filing above the soft offer cap.

Note: The ISO has also posted draft tariff language related to this initiative and is asking stakeholders to submit comments on the draft language. Please include edits to the proposed language in the word document available here.