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COMMENTS OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA ON THE DECEMBER 19, 2017 CRR AUCTION EFFICIENCY STAKEHOLDER WORKING GROUP MEETING

In response to the ISO's request, the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, the "Six Cities") provide their comments on the presentations and discussions in the December 19, 2017 CRR Auction Efficiency Stakeholder Working Group Meeting ("the Meeting"):

Parallel Efforts to Develop Process Improvements and CRR Auction Design Modifications - -

The ISO's November 21, 2017 CRR Auction Analysis Report ("the Report") identified differences between the network models used for the CRR auctions and the models used for Day-Ahead Market optimization as sources of differences between CRR auction revenues and payouts to holders of auctioned CRRs. The ISO's presentation at the Meeting summarized a number of measures that could be taken to improve both the accuracy of the network models used in the CRR auctions and consistency of the models used in the CRR auctions with the models used for Day-Ahead Market optimization. *See* the Servedio presentation at Slides 7-12. The Six Cities support prompt implementation of measures that will reduce differences between the models used for the CRR auctions and the models used for Day-ahead optimization and that can be developed quickly and without tariff modifications.

However, in light of the temporal separations between the CRR auctions and Day-Ahead Market processes, it seems unlikely that differences between the models used in those processes ever could be eliminated entirely, and the extent to which such differences can be reduced is uncertain. *See, e.g.*, the Report at 202-203. Therefore, efforts to improve the models used for the CRR auctions should not delay consideration or implementation of changes to the CRR auction design to relieve LSEs and their customers of the obligation to support payments to holders of auctioned CRRs in excess of revenues received from the CRR auctions. Development of appropriate changes to the CRR auction design should proceed in parallel with enhancements to the models used in the CRR auctions, and design changes that affect the annual CRR auction should be implemented prior to the 2019 auction for annual CRRs for 2020.

Modifications to the CRR Auction Design - -

The ISO's Department of Market Monitoring ("DMM") has documented over the past several years, and the Report confirms, that revenues received from the annual and monthly CRR auctions persistently fall significantly short of congestion payments made to the holders of the auctioned CRRs. The payments to holders of auctioned CRRs have exceeded auction revenues by more than $ 680 million since 2009 and by an average of approximately $ 75 million per

year.[1] It also is undisputed that a very high percentage (approximately 87 percent) of the payments to holders of auctioned CRRs in excess of auction revenues have been to financial traders and marketers, *i.e.*, market participants that do not produce or consume energy.

Data in the Report suggests that a substantial volume of the transactions in the CRR auctions involves financial speculation as opposed to hedging for physical sales or purchases. The Report indicates that high percentages of CRRs awarded in the monthly auctions (92% for Off-peak periods and 76% for On-peak periods) clear within the price range of negative $ 0.25/MWh to positive $ 0.25/MWh. Report at 34. The predominantly low prices for auctioned CRRs suggest that they are not purchased primarily for the purpose of hedging physical transactions but rather represent a form of lottery in which financial speculators can acquire a large portfolio of auctioned CRRs for modest payments and then profit from the payout of congestion revenues attributable to a few CRRs within the portfolio. The Report also states that large numbers of CRRs released in the auctions are for CRR definitions with very few awards, and that approximately half of the auctioned CRRs are based on CRR definitions with one single award. The Six Cities join the ISO in questioning how much liquidity or hedging the auctions may be providing given the large volume of single definition awards. *See* Report at 10.

The current CRR auction design forces LSEs and their customers to backstop payments to holders of auctioned CRRs, whether or not they are able to or wish to participate in the CRR auctions. Participation in the CRR auctions to purchase CRRs is voluntary, but LSEs effectively are forced to sell CRRs in the auctions whether or not they wish to do so. There is no justification for forcing customers to bear the risk of differences between auction revenues and congestion payouts. Although some market participants assert that customers receive intangible or unquantifiable benefits from the CRR auctions, there has been no attempt to demonstrate that benefits to customers from the CRR auctions even begin to approach the $75 million per year burden imposed on customers by the auctions. Generalized claims of intangible or unquantifiable benefits cannot support the massive transfers of wealth from customers to financial speculators that have occurred and continue to occur under the current CRR auction design.

The Six Cities support suggestions by SCE and other stakeholders to pursue modifications to the design of the CRR auctions so as to include participation by willing buyers and willing sellers only, eliminating any obligation for LSEs (or any other non-willing participants) to make up shortfalls between auction revenues and payments to holders of auctioned CRRs. Market participants that wish to participate in CRR auctions (whether for purposes of hedging or for speculation) would have the ability to do so. If the CRR auctions

[1] CAISO Department of Market Monitoring, "Problems in the performance and design of the congestion revenue right auction" (November 27, 2017) at 11.

offer value, it is reasonable to anticipate that participation by willing buyers and willing sellers will occur and will capture that value.

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