



ORA

Office of Ratepayer Advocates
California Public Utilities Commission

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THE OFFICE OF RATEPAYER ADVOCATES' COMMENTS
ON THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR'S (CAISO)
CONGESTION REVENUE RIGHTS (CRR) AUCTION EFFICIENCY TRACK 1B DRAFT
FINAL PROPOSAL ADDENDUM

June 7, 2018

The Office of Ratepayer Advocates (ORA) is the independent consumer advocate within the California Public Utilities Commission (CPUC), with a mandate to obtain the lowest possible rates for utility services consistent with reliable and safe service levels, and the state's environmental goals.

ORA submits these comments and recommendations in response to the CAISO's May 25, 2018, *Congestion Revenue Rights Auction Efficiency Track 1B Draft Final Proposal Addendum*.¹ The Track 1B Final Proposal is intended to "further address the systemically high payouts to CRRs due to modeling differences in the DAM (Day-Ahead Market) and the CRR Auction market."² These modeling differences are the cause of persistent shortfalls³ that ratepayers must subsidize through the transmission access charge (TAC).⁴

In the Track 1B Proposal, the CAISO proposes to move to ex-post partial funding to better align payouts in the DAM with CRR auction modeling results. This approach would reduce CRR payments based on the effectiveness of the constraint in generating CRR shortfalls so that the CAISO does not pay CRR holders more than the available DAM congestion revenue.⁵

ORA supports ex-post partial funding on a constraint-by-constraint basis in order to limit rent seeking behavior by entities seeking to profit from differences between CRR's and DAM's

¹ *Congestion Revenue Rights Auction Efficiency Track 1B Draft Final Proposal Addendum*, May 25, 2018 (CRR 1B Draft Final Proposal or Draft Final Proposal).

² CRR 1B Draft Final Proposal, p. 5.

³ CRR 1B Draft Final Proposal, p. 6.

⁴ *Market Alternatives to the Congestion Revenue Rights Auction*, CAISO Department of Market Monitoring (DMM), November 27, 2017, p. 2.

⁵ CRR 1B Draft Final Proposal, p. 27. This method is also known as ex-post partial funding, and is employed by many other independent system operators (ISOs) and regional transmission organizations (RTOs).

modeling results. ORA also recommends that the CAISO consider more equitable ways to allocate the shortfalls on constraints.

The CAISO's CRR 1B Draft Final Proposal would curtail payments only in the prevailing flow direction.⁶ ORA supports this change, and additionally supports the CAISO's decision to ultimately return any remaining surpluses to measured demand, but requests clarification regarding how the CAISO plans to return these surpluses. ORA recommends that the CAISO use the surpluses to reduce the TAC.⁷

ORA continues to oppose the CAISO's decision to forego further consideration of the willing counterparty auction design. The CAISO's proposed solutions to improve existing CRR auction design will at best mitigate but not eliminate the auction's fundamental flaws.⁸ The CAISO should further consider the willing counterparty proposal in Track 2 of this initiative, including how to match CRR auction counterparties.

Ex-post partial funding would limit shortfalls resulting from CRR modeling limitations to the constraints that experience shortfalls, but the CAISO should consider how to more equitably allocate shortfalls on each constraint.

The CAISO contends that the current full funding for CRRs incentivizes rent-seeking behavior by encouraging participants to target modeling differences between the DAM and the CRR auction in expectation of higher payouts.⁹ CAISO observes that full funding "transfers the cost" for the shortfalls to "measured demand, even though measured demand may have little to no control over the causes of the shortfall."¹⁰ Correspondingly, the CAISO finds that "[a]llocating this revenue inadequacy directly back to congestion revenue rights rather than to load would reduce these incentives."¹¹

⁶ "[T]he CAISO has reconsidered this approach, and now proposes to only reduce the payment to congestion revenue rights in the prevailing flow direction in the event of an over-subscribed constraint." CRR 1B Draft Final Proposal, p. 5.

⁷ "[T]he CAISO should maintain separate balancing accounts for the allocation and auction markets. This is because a joint balancing account may account for a cross-subsidy on auction shortfalls from load (who are receiving allocations). The CAISO should apply surplus revenues generated over each constraint in the auction to reduce the Transmission Access Charge (TAC) funds paid by ratepayers." *ORA Comments on the Track 1B Straw Proposal*, May 4, 2018, p. 4.

Department of Market Monitoring Comments on the CRR Auction Analysis Working Group, January 16, 2018, p. 3. DMM explains at page 3 that CRRs are poorly defined property rights and that the existing market design relies on conscripted sellers.

⁹ "Full funding of congestion revenue rights creates incentives that exacerbate congestion revenue right revenue inadequacy and auction revenue shortfalls." CRR 1B Draft Final Proposal, p. 25.

¹⁰ CRR 1B Draft Final Proposal, p. 25.

¹¹ CRR 1B Draft Final Proposal, p. 28.

To combat existing incentives to exploit weaknesses in the CAISO’s modeling, the CAISO proposes to limit payments to CRR holders to the revenues generated at each CRR constraint.¹² The CAISO would calculate the revenue shortfall on a constraint-per-constraint basis, meaning that if a shortfall occurs over a constraint, payments would be reduced for entities that purchased CRRs over that constraint.¹³ CRR holders would bear shortfalls commensurate with their flows over constraints in the day-ahead market.¹⁴ This would shift payment of the CRR revenue shortfalls from measured demand to the CRR holders.

However, as the Six Cities point out, the proposed solution negatively impacts market participants seeking to hedge their energy transactions, because “it will no longer be possible for a market participant to guarantee that a physical power delivery path is 100% hedged...”¹⁵ Moreover, the Six Cities note that market participants that “abide by the CAISO’s allocation and auction rules are not ‘causing’ revenue shortfalls attributable to modeling inconsistencies...”¹⁶ Instead, the revenue shortfalls are caused by imperfections in the CAISO’s modeling process.¹⁷ The Six Cities, therefore, recommend that rather than requiring CRR holders on a particular constraint to be solely responsible for shortfalls on that constraint, the shortfall should be allocated to all participants in the CRR market. The Six Cities’ proposal for allocating CRR revenue shortfall is an improvement on the current market design in which only measured demand is responsible for funding CRR auction shortfalls. However, the Six Cities’ proposal to socialize the costs of shortfalls at a constraint would not eliminate incentives for CRR auction participants to target modeling flaws at particular constraints.

ORA continues to support the concept of limiting revenue shortfalls to the constraints that experience shortfalls in order to eliminate incentives for CRR auction participants to target modeling flaws at particular constraints. ORA also now recommends that the CAISO consider a more equitable way to allocate the shortfall on a particular constraint. For instance, CCSF (City and County of San Francisco) proposed that the CAISO could allocate shortfalls in a similar way to the ex-ante partial funding allocation proposed in the same CRR 1B Draft Final Proposal.¹⁸

¹² CRR 1B Draft Final Proposal, p. 28.

¹³ CRR 1B Final Proposal, p.28

¹⁴ CRR 1B Draft Final Proposal, p. 29.

¹⁵ *Comments of the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California on the Congestion Revenue Rights Auction Efficiency Track 1b Straw Proposal*. May 4, 2018 (Six Cities Comments), p. 1.

¹⁶ Six Cities Comments, p. 2.

¹⁷ Six Cities Comments, p. 2.

¹⁸ “CAISO should consider alternative approaches for allocating revenue inadequacy that would be more equitable considering the costs for participating in the allocation and auction processes. For example, CAISO could apply the shortfall first to the lowest value auction CRRs, then to the highest value auction CRRs, then to allocation CRRs, similar to the approach included in the ex ante de-rate approach CAISO discussed with the Market Surveillance Committee on April 5, 2018. This approach would prioritize the allocation of the shortfall to those who contributed the least in recovering the cost of the underlying transmission system that supports the CRR auction, and it would recognize that the auction CRRs contribute more to the revenue inadequacy than the allocation CRRs because the revenue inadequacy

This shortfall allocation would also value CRRs based on their contribution to the shortfall, with low-value holders paying more shortfalls than higher-value CRRs, and allocated CRR holders paying the least. The Six Cities advocated for proportional reallocation of CRRs commensurate with CRR market costs and revenues.¹⁹ While ORA does not support the proposal to apply the proportional reallocation across the whole CRR market, the concept should be considered for the allocation of shortfalls on a constraint by constraint basis.

ORA supports removing counter-flows from the shortfall allocation.

The CAISO plans to partially fund payments on each oversubscribed constraint only in the prevailing flow direction, rather than both the prevailing flow and counter-flow directions.²⁰ The CAISO reasons that this is more in line with the adjustments made in the Simultaneous Feasibility Test (SFT).²¹ The CAISO further reasons that because counter-flow CRRs do not contribute to oversubscriptions on constraints, this would not represent an efficient derate.²² Based on the CAISO’s reasoning, ORA supports removing counter-flows from the shortfall allocation.

ORA supports ultimately returning surpluses to measured demand.

In response to stakeholder input on the Track 1B Straw Proposal, the CAISO plans to distribute surpluses in a tiered approach. First, any surpluses generated in a 24-hour period will be used to settle payments on any hourly basis. If any surpluses remain after a daily settlement, the surplus will then be used to settle payments on a monthly basis. Finally, if any surplus remains after the daily and monthly settlement, the surplus will be returned to measured demand on a monthly basis.²³ Generally, all surpluses generated on that constraint will remain tied to that constraint, and not used to settle any payments on any other constraints in the system.

ORA supports the CAISO’s general surplus allocation plans, especially the CAISO’s plan to return any outstanding surpluses back to measured demand.²⁴

would be decreased, in the absence of the auction CRRs.” *CCSF Comments on CAISO CRR Auction Efficiency*, May 4, 2018, pp. 1-2.

¹⁹ Six Cities Comments, p. 5.

²⁰ CRR 1B Draft Final Proposal, p.31.

²¹ CRR 1B Draft Final Proposal, p. 31.

²² CRR 1B Draft Final Proposal, p. 31.

²³ CRR 1B Draft Final Proposal, P. 32.

²⁴ CRR 1B Draft Final Proposal, p.33.

Conclusion

The CAISO's and stakeholders' studies and evidence demonstrate that the current CRR market is producing "inefficient outcomes."²⁵ The result is that "market participants purchase congestion revenue rights for 63 cents on the dollar."²⁶ Any shortfalls between day-ahead congestion charges and real-time market prices are uplifted to load, which CAISO terms "net payment deficiencies."²⁷ The net payment deficiency from 2009 to date exceeds \$750 million.²⁸

ORA supports the move to ex-post partial funding as an interim solution to the flawed CRR market design, but recommends further consideration of how to more equitably allocate the shortfall on oversubscribed constraints. However, the CAISO should further consider the willing counterparty proposal in Track 2 of this initiative. The current Track 1B process fails to adequately explore the ways the willing counterparty proposal could work, including how to most efficiently identify potential buyers and sellers of CRRs.

Please contact Danielle Dooley at Danielle.Dooley@cpuc.ca.gov or 415-703-3666 with any questions or comments.

²⁵ Track 1 Draft Final Proposal Paper, p. 3.

²⁶ Track 1 Draft Final Proposal Paper, p. 3.

²⁷ Track 1 Draft Final Proposal Paper, p. 3.

²⁸ *Department of Market Monitoring Report Comments on CRR Proposal Memorandum*, March 14, 2018, Eric Hildebrandt, p. 2.