Comments on the Draft Stakeholder Initiatives Catalog

Department of Market Monitoring
September 30, 2016

Overview

DMM appreciates that the ISO faces a wide range of issues that are important to stakeholders; federal, state and regional policy makers; the ISO's strategic goals – and has limited resources to address these issues by developing and implementing effective options and solutions. To meet this challenge, the ISO must carefully select and prioritize the initiatives it undertakes and the scope of these initiatives. To maximize benefits from the ISO's limited resources, the ISO must select, prioritize and set the scope of initiatives based on an assessment of the relative benefits and costs of various options and initiatives.

Given this framework, DMM believes the ISO should place highest priority on addressing the following issues in 2017. DMM looks forward to working with the ISO and stakholders on these initiatives.

Congestion revenue rights auction (Initiative 12.1)

As described in DMM's *2015 Annual Report* and *Q2 2016 Report*, electric ratepayers have consistently received significantly less revenues from the congestion revenue rights auction compared to the congestion payments received by entities purchasing these rights.[1] DMM believes that addressing this problem through a stakeholder initiative represents an opportunity for around $50 to $130 million per year in benefits for transmission ratepayers.[2] And unlike virtually all other intiatives, the ultimate implementation cost for this initaive should be essentially negative and free up ISO resources to work on other issues.

DMM has provided specific recommendations and options for addressing this issue and is prepared to lead the development and assessment of DMM recommendations and any other issues and options identified by the ISO or market participants. For example, in response to the concern expressed by generators that eliminating the CRR auction will make it difficult for them

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[1] *2015 Annual Report on Market Issues and Performance*, Department of Market Monitoring, May 2016, pp. 182-190, 225-226: http://www.caiso.com/Documents/2015AnnualReportonMarketIssuesandPerformance.pdf.

Q2 2016 Report on Market Issues and Performance, Department of Market Monitoring, August 2016, pp. 51-57: http://www.caiso.com/Documents/2016SecondQuarterReportMarketIssuesandPerformance.pdf.

[2] Through the first half of 2016, ratepayer losses from auctioning CRRs were on pace to be roughly $55 million in 2016. The losses have averaged roughly $130 million per year from 2012-2015. See *Q2 2016 Report on Market Issues and Performance*, Department of Market Monitoring, August 2016, p. 51: http://www.caiso.com/Documents/2016SecondQuarterReportMarketIssuesandPerformance.pdf.

to procure financial hedges, DMM has suggested that the ISO could simply convert the CRR *auction* into a CRR *marke*t based on bids from willing buyers and sellers.

DMM recognizes this initiative will be highly controversial due to the large amount of money involved from the perspective of different parties. In particular, a relatively small number of financial entities currently receive millions of dollar in profits each year which would instead go to transmission ratepayers under DMM's proposal. These financial entities are certain to oppose the proposal.

However, DMM believes the actual effort needed by the ISO to develop and assess this proposal and alternatives that might be proposed is quite limited compared to the benefits of this issue to ratepayers and the effort needed from the ISO to address other issues. Unlike many initiatives, the proposal is already well defined and does not involve development of significant additional market design and software details.

The ISO Board has expressed significant interest in this issue. DMM has requested that the Board be provided the option of providing input on this issue as part of this process, rather than after the ISO has already developed its recommendations.

Commitment costs and DEB enhancements (Inititiatve 5.13)

DMM supports the ISO's interest in maximizing market efficiency by ensuring that bid caps for commitment costs and default energy bids for gas units accurately represent actual gas costs in the day-ahead and real-time market. DMM has been proactively addressing this issue over the last few years and has performed extensive analysis of actual gas market price and trading data.

Based on this analysis, DMM is recommending that as part of this initiative the ISO can enhance the current process and make as prices used by the ISO to calculate bid caps even more accurate by implementing four basic steps.

First, DMM believes the gas price used to calculate caps used in the ISO's day-ahead market should be based on an updated index calculated by the ISO by taking a weighted average of trade prices on the InterContinental Exchange, also known as ICE, just prior to the day-ahead market run. This will effectively eliminate the one day lag in the natural gas prices used in the ISO day-ahead market. This change should ensure that virtually all gas purchased in the next day market is at a price that is within the normal headroom provided under current market rules (10 percent for default energy bids and 25 percent for commitment costs). This is supported by analysis done by DMM of ICE data going back over several years.

Second, next day gas indices used in the day-ahead market can be different from traded values because Mondays (or Tuesday if that is the first trade day of the week) trade as part of a weekend package. DMM believes this source of potential inaccuracy could be addressed by adjustments to target this specific situation. For example, ICE includes a Monday only gas product. Moreover, participants have the ability to create a custom product on ICE that is equivalent to the Monday only next-day trading product. The ISO has the ability to observe trades for these products and could incorporate the prices for these trades in the index that is used for the first trading day of the week rather than just relying on the current index value that is part of the weekend package.

Third, for the real-time market, DMM believes that the ISO could update real-time gas indices each morning based on observed trades in the same day market natural gas market. This approach would be similar to that used to update next-day natural gas prices in the day-ahead market. Specifically, by about 8:30 a.m. of each operating day the ISO can calculate a weighted average of trade prices for same day gas traded on ICE. This price can then be used to update bids in the real-time market for that day. Recent analysis by DMM indicates that this approach would provide a price that is close to the final average for same day gas prices by ICE, since much of the same day trading occurs by 8:30 a.m. each day.

Fourth, we recommended that suppliers be allowed to file for recovery of certain gas costs not recovered through market revenues. We believe that the need for such cost recovery filing should be very limited – especially if the three modifications described above are implemented. However, we are encouraging the ISO – or FERC – to develop more specific guidelines and details of these cost recovery provision.

DMM believes that if the ISO runs an efficient, focused stakeholder process these measures can be implemented by fall 2017 or earlier. Once these steps are in place, the ISO can consider options for allowing generators to submit natural gas prices in excess of these observed market prices and establishing a process for the ISO to pre-validate any such requests for use in the market.

DMM believes that developing a process to dynamically determine if resources may have market power for dynamic mitigation of commitment cost bids will be relatively complicated. Therefore, we believe that the ISO should place priority on implementing processes for updating natural gas prices before expending extensive resources on this enhancement.