

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**California Independent System) Docket No. ER18-641-000
Operator Corporation)**

**MOTION TO INTERVENE AND PROTEST OF THE DEPARTMENT OF
MARKET MONITORING OF THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

Pursuant to Rules 211, 212, and 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”), 18 C.F.R. §§ 385.211, 385.212, 385.214, the Department of Market Monitoring (DMM), acting in its capacity as the Independent Market Monitor for the California Independent System Operator Corporation (“CAISO”), submits in the above captioned proceeding this motion to intervene and protest for the reasons discussed herein.

In this proceeding, CAISO proposes revisions to its existing Risk-of-Retirement (ROR) Capacity Procurement Mechanism (CPM) to issue allow the CAISO to issue ROR CPMs on the earlier timeline. DMM supports expanding the CAISO’s authority to issue ROR CPMs on the earlier timeline under the process that would be established in the CAISO’s filing. However, DMM opposes the compensation provided to ROR CPM resources under the CAISO’s proposed ROR CPM provisions. Resources receiving a ROR CPM designation would receive a fixed payment covering of all fixed costs (including sunk investment costs) plus a return on equity. In addition, ROR CPM resources would receive all market revenues that result from participation in the CAISO and bilateral

energy markets. This compensation is unjust and reasonable, can create market inefficiencies, and may undermine California's resource adequacy program and the CPM competitive solicitation processes. DMM respectfully recommends that the ROR CPM proposal be approved only if or when the proposed compensation for ROR CPM resources is lowered.

I. MOTION TO INTERVENE

DMM respectfully requests that the Commission afford due consideration to this protest and motion to intervene, and afford DMM full rights as a party to this proceeding. The mission of DMM – like that of all Independent Market Monitors – is as follows:

To provide independent oversight and analysis of the CAISO Markets for the protection of consumers and Market Participants by the identification and reporting of market design flaws, potential market rule violations, and market power abuses.¹

The CAISO tariff states that “DMM shall review existing and proposed market rules, tariff provisions, and market design elements and recommend proposed rule and tariff changes to the CAISO, the CAISO Governing Board, FERC staff, the California Public Utilities Commission, Market Participants, and other interested entities.”² As this proceeding involves flawed CPM tariff provisions which are unjust

¹ CAISO Tariff Appendix P, Section 1.2.

http://www.caiso.com/Documents/AppendixP_CAISODepartmentOfMarketMonitoring_asof_Apr1_2017.pdf.

See also FERC Order 719, at p. 188, where the functions of a Market Monitor include: “evaluating existing and proposed market rules, tariff provisions and market design elements, and recommending proposed rule and tariff changes not only to the RTO or ISO, but also to the Commission’s Office of Energy Market Regulation staff and to other interested entities [...]” <https://www.ferc.gov/whats-new/comm-meet/2008/101608/E-1.pdf>

² CAISO Tariff Appendix P, Section 5.1.

and unreasonable, potentially inefficient and may undermine California's resource adequacy process, it implicates matters within DMM's purview.

II. PROTEST

Background

As noted in the CAISO's filing, DMM supported the CAISO's ROR CPM proposal in comments submitted in the stakeholder process and to the CAISO Board of Governors. As DMM explained in its memo to the CAISO Board on this issue:

Several aspects of the proposal reduce the likelihood that a resource will feign retirement in order to receive risk of retirement CPM designation. Management proposes to compensate a resource who receives a risk of retirement CPM at the resource's cost-of-service. *The cost-of-service compensation reduces the potential for resources to seek extra rents from risk of retirement CPM designations compared to compensation at the regular CPM soft offer cap – which DMM expects should exceed the cost of service for many resources.* The resource owner must also attest in writing that they intend to retire the unit. This increases the difficulty of potential gaming aimed at obtaining CPM payments in the proposed risk of retirement process. [emphasis added]³

Thus, DMM supported the proposal based on the explicit expectation that the compensation for ROR-CPM units would typically be less than the regular CPM soft cap, which is based on the *going forward fixed costs* (GFFC) of a typical unit. However, DMM's prior support for the CAISO's proposal was unfortunately based on an outdated understanding of the definition of the *cost of service* for units receiving CPM designations included in the current CAISO tariff and ROR CPM proposal.

From 2007 through 2015, units designated under the CAISO's backstop procurement authority to California's resource adequacy program were eligible to file

³ Memorandum to ISO Board of Governors, Eric Hildebrandt, Director, Market Monitoring, October 25, 2017, Re: Department of Market Monitoring Report, p. 2
http://www.caiso.com/Documents/Department_MarketMonitoringUpdate-Nov2017.pdf

at FERC for recovery of *going forward fixed costs* (GFFC) plus a 10 percent adder. However, under tariff revisions that resulted from a 2015 settlement process, CPM units may seek cost recovery based on the methodology for determining the annual fixed revenue requirement (AFRR) of an RMR Condition 2 unit contained in Schedule F of the *pro forma* RMR Agreement.⁴ This formula includes all sunk fixed costs plus a 12.5 percent return on investment. In addition, resources under CPM designations receive all the market revenues that result from participation in the CAISO and bilateral energy markets.

DMM sincerely regrets not recognizing that the cost of service that may be used in the ROR-CPM cost justification process might include the AFRR (including sunk cost and return may be used on investment) rather than a units GFFC plus a reasonable contribution to sunk fixed costs. This error of omission caused DMM to support the CAISO proposal based on its outdated assumption that units receiving ROR CPMs would be compensated based on their GFFC plus a 20 percent adder (i.e. the same approach used to determine the CPM soft cap). Had DMM not erred in this manner, it certainly would not have supported the CAISO's ROR-CPM proposal during the stakeholder and Board approval process. Again, DMM sincerely apologizes for this oversight and misunderstanding.

⁴ DMM was excluded by ISO staff from the 2015 settlement process that resulted in the CAISO's May 2015 Offer of Settlement, which led to change in the CPM cost justification provisions of the CAISO tariff. However, the fact that compensation of CPM resources may be based on Schedule F of the RMR contract was noted in the CAISO's ROR CPM proposal. DMM regrets not noticing the modification to the prior definition of the cost-of-service as part of this stakeholder process. Based on recent stakeholder discussions, DMM understands that it is not the only entity participating this stakeholder process making this misunderstanding or oversight.

DMM and the CAISO both have a long history dating back to 1999 of supporting the principle that units needed for local or system reliability which have market power should be compensated based on GFFC plus a reasonable contribution to sunk fixed costs. Thus, DMM believes that the CAISO's ROR-CPM filing should be rejected and the CAISO's CPM and RMR provisions can and should be modified to be consistent with this key market design principle.

The proposed compensation for ROR CPM resources would unjustly reward units with unilateral market power

The CAISO's ROR CPM provisions, which were first implemented in 2011, permit the CAISO to procure a resource needed for reliability that does not have a resource adequacy (RA) contract in the current or imminent resource adequacy compliance year. The CAISO has determined that it should improve the existing designation process to allow CAISO to signal earlier in the year its intent to issue an ROR CPM designation to a resource for the upcoming year. This change would address valid issues raised by resource owners. Providing an earlier signal regarding the need for a specific resource to meet reliability needs can also prevent unnecessary over procurement.

To exercise this authority, the CAISO "must determine that the resource is uniquely situated as the only one that can meet the identified reliability need as a condition for issuing the requested designation, i.e., there is no competing or

alternative resource that LSEs could otherwise procure in the RA process.”⁵ Thus, units receiving ROR CPM designations will have complete unilateral market power.

The CAISO filing acknowledges that units receiving ROR CPM and RMR designations are specifically needed for reliability (i.e. have market power), and argues that it is therefore appropriate to compensate ROR CPM and RMR unit owners for fixed costs in the same manner.⁶

A resource issued an ROR CPM designation and an RMR unit are alike in that each is needed for reliability on a resource-specific basis. Unlike all the other types of resources with CPM designations, the CPM competitive solicitation process does not apply to ROR CPM designations. It is accordingly reasonable to use the same approach to compensate the resource owners for their fixed costs.⁷

However, DMM and numerous other parties have previously noted that compensation for RMR Condition 2 resources under Schedule F is unjust and unreasonable and is likely to result in significant inefficiencies and price distortions in the CAISO’s energy market.⁸ As noted in DMM’s recent protest of the CAISO’s RMR contract provisions:

The flaws of RMR Condition 2 contracts are well known and must now be addressed. Condition 2 of the RMR contract provisions was established over 17 years ago as part of a contentious settlement reached during the ISO’s second year of operation. The CAISO and the state’s investor owned utilities and state regulators agreed to the 1999 settlement to ensure reliability and improve the efficiency of California’s nascent electricity market when

⁵ California Independent System Operator Corporation submits tariff filing per 35.13(a)(2)(iii): 2018-01-12 CPM Risk of Retirement Amendment to be effective 4/13/2018 under ER18-641 Transmittal Letter, at pp. 3-4. <https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=14796643> .

⁶ *Id.*

⁷ *Id.* at, p.34.

⁸ Order Accepting and Suspending Reliability Must-Run Agreement and Establishing Hearing and Settlement Judge Procedures re Metcalf Energy Center, LLC under ER18-240, pp. 6-8. <https://elibrary.ferc.gov/IDMWS/common/OpenNat.asp?fileID=14787684>

compared to prior RMR contract provisions in effect at that time.⁹ The CAISO supported the settlement to avoid “costly litigation” and “regulatory uncertainty” and “promote administrative efficiency.” However, support for the 1999 settlement by the CAISO and the state’s investor owned utilities and state regulators was explicitly conditioned on the expectation that the amount of generation under Condition 2 would be very limited.¹⁰

Moreover, the provisions of the ROR CPM are actually akin to allowing generators to select the “best of” Condition 1 and Condition 2 RMR contracts in terms of compensation for their resources. Like Condition 2 units, ROR CPM units receive guaranteed recovery of all sunk fixed costs plus a 12.5 percent return on investment. But like Condition 1 units, ROR CPM resources are not limited in the way they can participate in the market and retain all market revenues earned when operating in the CAISO or bilateral markets. This is not just, reasonable or efficient.

The CAISO’s filing acknowledges that it would not be appropriate to compensate resources with ROR CPM designations with a price in excess of their cost of service:

Further, resources with ROR CPM designations are essentially receiving “bridge” payments until the year they are needed for reliability. Until that time, they should not be paid a price in excess of their full cost of service for a year in which they are not needed for reliability purposes. Indeed, a resource with an ROR CPM designation that is not immediately needed for reliability purposes should not be eligible to receive a market-based price that is higher than the cost-based price paid to a resource that is needed for reliability purposes now, *i.e.*, an RMR unit.¹¹

⁹ Corrected joint opening brief of California Independent System Operator Corp et al filed on April 14, 2000 re proactive order issued by Chief Judge Wagner on 980126 under ER98-495 et al (Joint Parties Opening Brief). <https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=8078273>

¹⁰ Motion to Intervene and Protest of the Department of Market Monitoring of the California Independent System Operator Corporation under ER18-240, at pp. 9-10. <https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=14762784>

¹¹ CAISO Transmittal Letter, p. 35.

However, this this is exactly what the proposed CPM compensation would do. ROR-CPM resources would receive their full AFFR through a CPM payments, and would also receive all the market revenues from operation of the unit in the CAISO and bilateral markets. The sum of these fixed cost ROR CPM payments plus net market revenues exceed any reasonable definition of *cost-of-service* for units with market power.

It is unjust and unreasonable to provide a unit that has unilateral market power with guaranteed recovery of all fixed costs (including sunk investment costs) plus a return on equity – as well as all the market revenues that result from unlimited participation in the CAISO and bilateral energy markets. The purpose of limits on compensation incorporated in backstop mechanisms such as the CPM and RMR provisions of the CAISO tariff is to *mitigate* market power – not *reward* units with market power with compensation in excess of what the generator would earn in a competitive market. As described below, the proposed compensation for ROR-CPM units can also create market inefficiencies and may undermine California’s resource adequacy program and CAISO’s CPM competitive solicitation process.

Backstop mechanisms based on guaranteed recovery of sunk costs plus a return on investment can undermine the resource adequacy market

The resource adequacy program is the primary market for forward capacity contracts in the CAISO market. The CPM and RMR processes are meant to be backstop capacity procurement mechanisms through which the CAISO can ensure that system and local capacity needs are met.

Under Schedule F, a resource owner is guaranteed to recover and receive a rate of return on sunk investment costs that units receiving a CPM designation or RMR contract may not expect to recover through the resource adequacy market. Sunk costs should have no bearing on a resource's decision making and should not be reflected in competitive market outcomes.

Under CPM designations, the resource also keeps all net market revenues from operating the unit. Because this is much higher than units would often receive in a competitive market, resources might seek ROR CPM designations (or RMR contracts) rather than participate in the bilateral resource adequacy market even when competitive market payments would cover their actual economic costs of providing capacity.

CAISO's proposal to allow ROR-CPM units to receive full AFRR plus all net market revenues from operation make this scenario more likely, and thereby undermine the resource adequacy market. Thus, the proposed compensation for ROR-CPM units has the potential to be even more detrimental to the resource adequacy process than the current RMR options that allow recovery of AFRR under Schedule F.

Furthermore, resources can bid into other CPM competitive solicitation process subject to a soft offer cap. The soft offer cap was explicitly based on going forward fixed costs (plus 20 percent).¹² The guaranteed recovery of all

¹² California Independent System Operator Corporation, Docket No. ER15-1783, *Tariff Amendment and Offer of Settlement Regarding Capacity Procurement Mechanism Revisions and Request for Waiver of Notice Requirement*, May 26, 2015, transmittal letter, p. 2. <https://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=13885666>

sunk costs plus return on this investment provided to ROR-CPM units gives resources with potential market power the incentive to not bid their going forward fixed costs in other CPM competitive solicitation processes.

The proposed compensation for ROR CPM resources would encourage uneconomic and inefficient investments in alternatives.

Providing such high compensation to a ROR CPM resource would also encourage inefficient investment in alternatives that were actually less economic in meeting the local reliability need than the ROR CPM resource. The following example illustrates the difference in how the compensation of ROR CPM units should be set to create incentives for cost-effective alternatives.

Assume that the real annual incremental cost of keeping a ROR CPM resource in operation are about \$20 million, but that the resource would be eligible for a fixed ROR CPM payment of \$70 million per year based on its AFRR as determined through Schedule F.¹³ If there are alternatives to meeting this local reliability need (such as transmission or batteries) that cost between \$20 million and \$70 million per year, these would appear economic to implement from the perspective of load serving entities and regulators. However, this would represent an inefficient investment from a true economic perspective. In this example, up to \$70 million per year could need to be invested to avoid only \$20 million per year in actual going forward costs to meet a reliability need with an existing generation resource. Thus, basing ROR CPM compensation on the

¹³ The numbers in this example are based on approximate values for total fixed costs (including sunk costs and return on investment) versus the going forward fixed costs for the Metcalf Energy Center, which has been identified as an example of a unit that the ROR CPM is designed to cover.

going forward fixed cost of the resource provides the appropriate and efficient signal for investment in potential alternatives to meeting this local reliability need.

A similar example to this was provided nearly 20 years ago when the issue of fixed cost recovery under RMR contracts was litigated at FERC.¹⁴ The ALJ's decision in that case, which cited this example and other testimony in those proceedings, concluded that compensation based on going forward fixed costs (or "net incremental cost") was necessary to provide efficient price signals for new investment in alternatives to resources with local market power. As explained by the ALJ in this proceeding:

... compensating ... RMR availability obligations at net incremental cost would provide appropriate price signals for potential replacement resources. The record indicates that allocating sunk costs to RMR availability payments would create perverse incentives to invest in duplicative or uneconomic generation, transmission and demand-side management. In addition, allocating sunk costs to RMR availability payments also would undermine the ISO's ability meaningfully to determine and evaluate economically efficient alternatives to RMR generation under its Local Area Reliability System process.¹⁵

The goal of policy makers should not be to replace the need for ROR CPM resources at any cost. Rather, it should be to provide price signals that provide incentives for the most cost-effective way to meet the reliability requirement. Accordingly, it is inefficient to provide ROR CPM payments significantly in excess of the true incremental costs of continuing to meet reliability needs with the ROR CPM units.

¹⁴ Prepared rebuttal testimony of E Hildebrandt on behalf of California Independent System Operator Corporation re San Diego Gas & Electric Co under ER98-496 et al., at pp. 10-11. <https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=8351759>

¹⁵ Initial decision re Pacific Gas and Electric Company under ER98-495 et al., June 7, 2000 (Initial Decision), pp. 28-29. <https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=8381621>

The Commission has not required the CAISO guarantee recovery of annual fixed revenue requirement by CPM resources

Nearly 20 years ago, the CAISO and its market monitor clearly articulated the rationale for why it is most economically efficient and is just and reasonable to compensate units with local market power based on the incremental fixed costs of continuing to operate.¹⁶ In 1999, the CAISO joined the state's major investor owned utilities and CPUC to support the "net incremental cost methodology" as the appropriate means for mitigating market power of units needed to maintain local reliability.¹⁷ Under the "net incremental cost" approach, compensation for units under Condition 1 of the RMR contract received a fixed payment equal to their incremental fixed costs of operating in the market, less net operating revenues from participating in markets at market based rates.

The concept of providing a guarantee of full fixed cost recovery (including sunk costs) under Condition 2 of the RMR contract was accepted by the CAISO and other parties on a temporary basis to avoid "costly litigation" and "regulatory uncertainty" and "promote administrative efficiency."¹⁸ This issue of what constitutes efficient and equitable compensation with market power due to local

¹⁶ *Statement on Partial Settlement Filing, Eric Hildebrandt*, p. 9 (affidavit submitted as attachment to the CAISO's *Initial Comments of the California Independent System Operator in Support of Offer of Settlement*, ER98-495, April 19, 1999).

<https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=8075887>

¹⁷ Joint Parties Opening Brief.

¹⁸ *Initial Comments of the California Independent System Operator in Support of Offer of Settlement*, ER98-495, April 19, 1999, p. 3. In addition to being limited to about two years, the settlement included provisions for the terms of Condition 2 of the RMR contract to be revised before that time if Condition 2 had a significant negative impact on the market.

<https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=8075887>

reliability needs was litigated at the Commission, which ultimately upheld the “net incremental cost methodology” advocated by the CAISO. As found in that case:

RMR obligations are simply contractual mechanisms enabling generators enjoying unique— and therefore essential— locations in the interconnected transmission grid to participate in competitive markets for energy and ancillary services by mitigating those generators' ability to exploit local market power in limited circumstances. It follows that RMR unit availability should be compensated in an economically "transparent" manner: appropriate compensation should mitigate local market power, but neither unnecessarily advantage nor unnecessarily disadvantage RMR unit participation in competitive markets for energy and ancillary services. Net incremental cost compensation achieves these objectives.¹⁹

From 2007 through 2011, the Commission approved numerous filings which provided compensation for units under the CAISO's backstop procurement authority based on going forward fixed costs.²⁰ In 2011, the Commission did not approve a CPM filing by the CAISO based in part on concerns that basing compensation on going forward “going forward costs may create the potential for distorted pricing signals and deny resources a reasonable opportunity to recover fixed costs” and that the CAISO did not explain “how the use of going-forward costs for CPM compensation will provide incentives or revenue sufficiency for resources to perform long-term maintenance or make improvements that may be necessary to satisfy new environmental requirements or address reliability needs associated with renewable resource integration.”²¹

¹⁹ Initial Decision, at p. 26

²⁰ See discussion and citations in CAISO transmittal letter, pp.3-4.

²¹ Order on tariff revision re California Independent System Operator Corporation under ER11-2256, p.20 (FERC 2011 CPM Order).
<https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=12589782>

In a subsequent 2015 tariff filing and Offer of Settlement, the CAISO proposed increasing compensation for CPM resources through a “soft cap” based on an updated estimate of going forward fixed costs of a typical unit plus a 20 percent adder. As explained in the CAISO’s 2015 filing:

... the CAISO will procure backstop capacity through a competitive solicitation process and pay designated resources their bid price. A soft offer cap will apply to all offers into a competitive solicitation. The soft offer cap is based on the estimated levelized going-forward fixed costs of a merchant-constructed, mid-cost, 550 MW combined cycle unit with duct firing, as reflected in a cost study conducted by the California Energy Commission, plus a 20 percent adder.

Although the CPM soft cap is explicitly based on GFFC (plus a higher 20 percent adder), the CAISO’s 2015 tariff amendment and offer of settlement also changed the basis for cost justification (for compensation in excess of this soft cap) from GFFC to the AFRR calculation used for RMR condition 2 units. As noted in the 2015 filing:

Resources have the option to make a filing with the Commission to cost justify a price higher than the soft offer cap based on the formula applicable to Reliability Must Run Resources. These pricing provisions [i.e. the higher soft offer cap and opportunity to justify costs in excess of this cap based on AFRR] respond to the Commission’s guidance to provide enhanced fixed cost recovery opportunities to CPM resources.²²

The CAISO’s 2015 filing went on to explain that:

This CPM Soft Offer Cap adopted in the Offer of Settlement is just and reasonable, in the public interest, and a necessary complement to the competitive solicitation processes. Combined with the opportunity to make a resource-specific cost filing that can take into account all fixed costs (not just going-forward fixed costs), it is simultaneously *high enough* to ensure

²² California Independent System Operator Corporation, Docket No. ER15-1783, *Tariff Amendment and Offer of Settlement Regarding Capacity Procurement Mechanism Revisions and Request for Waiver of Notice Requirement*, May 26, 2015, transmittal letter, p. 2. <https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=13885675>

contributions to fixed cost recovery and *low enough* to provide appropriate market power mitigation.²³

When approving the CAISO's proposed soft cap for CPM compensation later in 2015, the Commission specifically found that:

CAISO's proposal to implement a soft offer cap of \$6.31/kW-month (\$75.68/kW-year), plus a 20 percent adder should allow sufficient recovery of fixed costs plus return on capital to facilitate incremental upgrades and improvements by resources. Further, because the soft offer cap represents the high end of the range of current resource adequacy prices, it should not create incentives for load serving entities to forego bilateral resource adequacy contracts and, instead, rely on CPM backstop procurement.

The Commission's 2015 Order did not indicate that providing guaranteed recovery of sunk fixed costs plus a return on investment needed to address the Commission's prior concerns. Thus, DMM believes the CAISO's CPM and RMR provisions can and should be modified based on the key market design principle that resources with market power should be mitigated based on going forward fixed cost. If needed, specific targeted provisions can be added to CPM and RMR provisions to address the Commission's prior concerns about setting cost-based compensation high enough to ensure proper long-term maintenance and incremental upgrades may be needed to "satisfy new environmental requirements or address reliability needs associated with renewable resource integration."²⁴

²³ Id., p.16

²⁴ FERC 2011 CPM Order, at p. 20.

III. OTHER COMMENTS

CAISO should continue efforts to make CPM designations the preferred backstop mechanism over RMR contracts

While DMM opposes use of Schedule F as the basis for compensating ROR CPM resources, CAISO's other proposed revisions would improve the ROR-CPM process. Currently, the relatively late date for determining a ROR CPM designation increases the likelihood a resource will seek a RMR contract instead of seeking a ROR CPM. A resource with a RMR contract does not have a must offer obligation and may actually have a requirement to *not offer* into the energy market. RMR contracts can create market inefficiencies when resources that could economically provide energy are instead held out of the market.

A CPM designation comes with a must-offer obligation. Therefore, absent changes in the RMR contract terms, CAISO's use of CPM designations would allow for more efficient energy market outcomes over relying on RMR contracts. CAISO's proposed ROR-CPM timeline would make the ROR-CPM a more viable option for resources considering retirement. CAISO should continue its efforts to improve the CPM processes and make CPM designations the preferred backstop mechanisms over RMR contracts.

Continued reforms of CPM, RMR and resource adequacy are needed

CAISO is continuing its efforts to reform and improve the CPM, RMR and resource adequacy processes. In 2018 CAISO is running several stakeholder initiative to address problems in the current RMR, CPM and resource adequacy

processes.²⁵ As part of these reforms, it is imperative that the CAISO redesigns RMR and CPM compensation based on Schedule F in a timely manner.

The CAISO's current plan for this stakeholder process appears to be limited to reviewing whether RMR contracts should have must offer obligations in the near term, and does not appear to include changes in RMR or CPM compensation until at least 2019.²⁶ DMM and the CAISO both have a long history of supporting the principle that units needed for local or system reliability which have market power should be compensated based on GFFC plus a reasonable contribution to sunk fixed costs. The CAISO's CPM and RMR provisions can and should be modified to be consistent with this key market design principle.

IV. CONCLUSION

DMM supports expanding the CAISO's authority to issue ROR-CPMs on the earlier timeline under the process that would be established in the CAISO's filing. However, DMM opposes the compensation provided to ROR-CPM resources under the CAISO's proposed ROR-CPM provisions. Resources receiving a ROR-CPM designation would receive a fixed payment covering all fixed costs (including sunk investment costs) plus a return on equity. In addition, ROR-CPM resources would receive all market revenues that result from participation in the CAISO and bilateral energy markets. This compensation is unjust and

²⁵ As stated on p. 29 of CAISO Market Infrastructure and Policy 2018 Policy Initiatives Road Map January 12, 2018: <http://www.caiso.com/Documents/2018FinalPolicyInitiativesRoadmap.pdf>

²⁶ Review of Reliability Must Run and Capacity Procurement Mechanism, Issue Paper and Straw Proposal for Phase 1 Items, at p. 3. <http://www.caiso.com/Documents/IssuePaperandStrawProposal-ReviewReliabilityMustRunandCapacityProcurementMechanism.pdf>

reasonable, can create market inefficiencies, and may undermine California's resource adequacy program and the CPM competitive solicitation processes.

DMM respectfully recommends that the ROR-CPM proposal be approved only if or when the proposed compensation for ROR-CPM resources is lowered. DMM and the CAISO both have a long history of supporting the principle that units needed for local or system reliability which have market power should be compensated based on GFFC plus a reasonable contribution to sunk fixed costs. Thus, DMM believes that the CAISO's ROR-CPM filing should be rejected and the CAISO's CPM and RMR provisions can and should be modified to be consistent with this key market design principle.

Respectfully submitted,

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Independent Market Monitor for the
California Independent System
Operator

Dated: February 2, 2018

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon the parties listed on the official service lists in the above-referenced proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 2nd day of February, 2018.

1st Anna Pascuzzo
Anna Pascuzzo