

COMMENTS OF ENERGY DIVISION STAFF ON THE DRAFT FINAL PROPOSAL FOR CONGESTION REVENUE RIGHTS AUCTION EFFICIENCY, TRACK 1 AND ON THE FEBRUARY 13, 2018 STAKEHOLDER MEETING

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INTRODUCTION

Energy Division staff (“ED staff”) appreciates the opportunity to comment on CAISO’s Draft Final Proposal for Track 1 of the Congestion Revenue Rights Auction Efficiency proceeding (“the Proposal”). ED staff’s comments are as follows:

1. ED staff understands and appreciates CAISO’s intention in issuing the Proposal.
2. Nevertheless, CAISO’s Track 1 proposal does not address fundamental flaws in the CRR construct, and alternative proposals that address those flaws do not include any components of CAISO’s Track 1 proposal. CAISO should forego submitting its Track 1 proposal to the Board of Governors in March 2018 and should instead re-scope Track 2 to consider the Track 1 proposal alongside more comprehensive changes to the CRR construct.

COMMENTS

ED staff understands and appreciates CAISO’s intention in issuing the Proposal.

CAISO has indicated that the primary motivation behind its Proposal is “to make changes that [CAISO] can implement for this year’s annual auction to reduce congestion revenue rights net payment deficiencies.”¹ ED staff appreciates and shares CAISO’s concern regarding net payment deficiencies. ED staff is particularly alarmed by DMM’s finding that as a result of these deficiencies, ratepayers lost over \$730 million from 2009 through 2017, or roughly \$82 million per year.² ED staff also recognizes that the Proposal is intended to arrest net revenue deficiencies as quickly as possible, which would benefit the load serving congestion revenue rights (CRR) holders to whom net revenue deficiencies (and surpluses) are ultimately allocated.

Nevertheless, CAISO’s Track 1 proposal does not address fundamental flaws in the CRR construct, and alternative proposals that address those flaws do not include any components of CAISO’s Track 1 proposal. CAISO should forego submitting its Track 1 proposal to the Board of Governors in March 2018 and should instead re-scope Track 2 to consider the Track 1 proposal alongside more comprehensive changes to the CRR construct.

¹ Congestion Revenue Rights Auction Efficiency Track 1 Draft Final Proposal at 3.

² Department of Market Monitoring, *Q4 2017 Report on Market Issues and Performance*, February 14, 2018, p. 24, available at <http://www.caiso.com/Documents/2017FourthQuarterReport-MarketIssues-PerformanceFebruary2018.pdf>.

Notwithstanding the intention to reduce net revenue deficiencies as soon as possible, ED staff believes the changes outlined in the Proposal do not address the fundamental flaw of the CRR construct: the absence of willing buyers and sellers on either side of a transaction. ED staff agrees with DMM that the current CRR construct “makes the ISO’s transmission ratepayers the counterparty to contracts bought from the CRR auction without being an explicit willing seller”³ and that “[a] market with well-defined property rights and trade confined to willing parties is much less susceptible to gaming and rent extraction than the current CRR auction.”⁴ State policy prohibits load serving investor owned utilities from using CRRs for any purpose other than hedging locational marginal price differentials,⁵ with the intention of protecting ratepayers from financial speculation in the CRR construct. Yet ratepayers are still exposed to speculation because as DMM has identified, they cannot prevent release into the auction process of some CRR capacity for which they would otherwise be eligible.⁶ Furthermore, in his seminal paper on CRRs, Hogan (1992) notes that their primary benefit is to enable entities with long term supply obligations to hedge against locational price differentials:

[I]n the presence of optimal spot prices, whenever the right holder is precluded [by optimal dispatch decisions and loop flow] from using the full capacity, the compensation received is just the amount needed to make the right holder indifferent between delivering the power or receiving the compensation. . . . At the margin, both the short-run user and the capacity-right holder would face the same incentives, but the capacity-right holder would also receive a rental payment that guarantees the economic viability of long-term power sale requirements.⁷

Adequate hedging activity by entities with long term supply obligations (i.e., load serving entities) is not possible when those entities cannot retain rights to the entire CRR capacity for which they are otherwise eligible. No component of the Proposal explicitly addresses this issue.

Both DMM⁸ and Southern California Edison⁹ have issued substantive proposals that address the fundamental issue of willing buyers and sellers. Under the current schedule for the CRR Auction

³ Department of Market Monitoring, *Problems in the Performance and Design of the Congestion Revenue Right Auction*, November 27, 2017, p. 2, available at https://www.caiso.com/Documents/DMMWhitePaper-Problems_Performance_Design_CongestionRevenueRightAuction-Nov27_2017.pdf.

⁴ Department of Market Monitoring, *Market Alternatives to the Congestion Revenue Rights Auction*, November 27, 2017, p. 5, available at http://www.caiso.com/Documents/DMMWhitePaper-Market_Alternatives_CongestionRevenueRightsAuction-Nov27_2017.pdf.

⁵ See CPUC Resolutions E-4117 OP 3 (available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/74083.PDF), E-4122 OP 3 (available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/74093.PDF), E-4124 OP 3 (available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/74103.PDF), E-4134 OP 3 (available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/76247.PDF), E-4135 OP 3 (available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/76251.PDF), and E-4136 OP 3 (available at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/76253.PDF).

⁶ Department of Market Monitoring, *Problems in the Performance and Design of the Congestion Revenue Right Auction*, November 27, 2017, p. 24.

⁷ Hogan, William W., “Contract Networks for Electric Power Transmission,” *Journal of Regulatory Economics* 4 (1992): 222.

⁸ Department of Market Monitoring, *Market Alternatives to the Congestion Revenue Rights Auction*, November 27, 2017.

⁹ Southern California Edison, *SCE CRR Proposal*, available at <http://www.caiso.com/Documents/SCEComments-CRR Auction Analysis Report.pdf>.

Efficiency proceeding, deeper changes to the CRR construct (such as those envisioned in the DMM and Southern California Edison proposals) would be considered in Track 2.¹⁰ Yet neither proposal includes any of the components of CAISO's Track 1 Draft Proposal, most notably those – such as reducing the number of eligible source-sink pairs and eliminating certain information from model disclosure – that received considerable opposition from a range of parties at the February 13, 2018 stakeholder meeting. Again, notwithstanding the Proposal's intention to reduce net revenue deficiencies as soon as possible, ED staff questions whether it is prudent to move forward with Track 1 when more holistic and durable solutions to the net payment deficiency issue (which may or may not include any of the components of the current Proposal) could be developed in Track 2. ED staff therefore urges CAISO to forego submitting its Track 1 proposal to the Board of Governors in March 2018 and to instead re-scope Track 2 to examine more substantive changes to the CRR construct alongside the components of the current Proposal. Considering the expediency for which CAISO clearly aims, ED staff supports the recommendations made by a coalition of load serving entities and a consumer representative in a letter delivered to CAISO management on March 6, 2018. These recommendations envision immediate consideration of changes to the CRR construct that would address the fundamental issue of willing buyers and sellers.

CONCLUSION

Whereas some components of the Proposal may have merit, ED staff believes it is ultimately counterproductive to move forward with the Proposal without considering more fundamental issues that will arise in Track 2. ED staff urges CAISO to forego submitting its Track 1 proposal to the Board of Governors in March 2018 and to incorporate Track 1 considerations into Track 2.

¹⁰ Page 5 of the *Congestion Revenue Rights Auction Efficiency Track 1 Draft Final Proposal* indicates that Track 2 will consider “potential comprehensive design changes in time for CAISO Board of Governors’ consideration in mid-2018.”