

Comments on FERC Order 831 – Import Bidding and Market Parameters: Issue Paper and Straw Proposal

Department of Market Monitoring

December 20, 2019

The Department of Market Monitoring (DMM) appreciates the opportunity to comment on the *FERC Order 831 – Import Bidding and Market Parameters Revised Straw Proposal* (Proposal).¹

Overview

DMM appreciates the ISO's efforts to consider requiring cost verification for all import bids over the \$1,000/MWh soft bid cap. DMM continues to support *ex ante* cost verification for import bids over the soft cap that can set market prices, with reliance on *ex post* verification only for cost recovery. In addition to the automated procedure for *ex ante* verification in the straw proposal, the ISO should also consider manual procedures to allow import bids over this level to set prices if suppliers can demonstrate to the ISO that their costs exceed this level sufficiently in advance of the timeline needed for market operations.

DMM also appreciates the ISO's willingness to reconsider its prior proposals to raise the administrative power balance constraint penalty parameter to \$2,000/MWh as part of its approach for Order 831 compliance. DMM supports keeping the administrative power balance constraint penalty prices at \$1,000/MWh. Raising the penalty price to \$2,000 would significantly affect settlements during periods of administrative pricing.

The original purpose of increasing the administrative penalty price to \$2,000 appears to be that the ISO thought it was necessary to allow a \$2,000/MWh hard bid cap. But raising the administrative penalty prices to \$2,000/MWh is not necessary to raise the hard bid cap as required by Order 831. Given the ISO's current scheduling and pricing runs, setting prices at the higher of the \$1,000 penalty parameter or cleared verified bids over \$1,000 during a constraint relaxation is feasible and relatively straight forward. This can be performed while allowing any pre-verified bids over \$1,000/MWh to set prices when the power balance constraint is not relaxed, as required by Order 831.

The ISO's straw proposal asserts that a higher \$2,000 administrative penalty price would improve incentives for supplier to bid their actual marginal costs. As explained in these comments, DMM strongly disagrees with this assertion. To the extent there is competition, the uniform price auction design creates incentives to bid true costs regardless of the power balance constraint penalty price. To the extent there is not competition, the power balance

¹ *FERC Order 831 – Import Bidding and Market Parameters Revised Straw Proposal*, California ISO, November 26, 2019: <http://www.caiso.com/InitiativeDocuments/RevisedStrawProposal-FERCOrder831-ImportBidding-MarketParameters.pdf>

constraint's administrative penalty price does not provide an incentive to bid true costs. In fact, DMM is concerned that under non-competitive conditions, raising the penalty price to \$2,000 may encourage physical withholding of supply in order to raise prices from \$1,000/MWh to \$2,000/MWh when no true scarcity exists.

A second way that the ISO now seeks to justify raising the penalty price to \$2,000 is by asserting that this would create greater incentives for resource – including resource adequacy imports -- to deliver any energy scheduled in the day-ahead market. As explained in these comments, raising the administrative penalty prices to \$2,000 would not be an effective way of ensuring the availability and delivery of resource adequacy imports in real-time. The ISO should address the problems with non-resource specific resource adequacy imports directly in its resource adequacy initiatives.

A third justification now offered by the ISO for raising the power balance constraint penalty parameter to \$2,000/MWh is by contending that this would provide an improved form of scarcity pricing. If the ISO seeks to modify its administrative scarcity pricing provisions, it should pursue a separate stakeholder initiative that considers various options.

Comments

Bids over the soft offer cap should be subject to cost verification.

DMM supports and appreciates the ISO's efforts to consider requiring cost verification for all import bids over the \$1,000/MWh soft bid cap. DMM continues to support ex ante (pre-market) cost verification for bids over the soft cap that are eligible to set prices and reliance on ex post verification only for cost recovery purposes.

The ISO should also consider manual procedures to allow resources to bid over the soft offer cap and set prices if they can demonstrate to the ISO that their costs exceed the cap established by the automated procedures being proposed by the ISO. Under this option, the supplier would need to meet the burden of demonstrating these costs to the ISO. Because this option would be designed to accommodate unusual situations that cannot be specified in advance, the ISO cannot provide very specific details of what information from suppliers and criteria would be used by the ISO to determine if such requests are justified.

In practice, it may often not be possible for the ISO to verify such requests on a timeline needed to allow bids to set market prices. However, that is not a reason to provide for this option. Although this option might be rarely used, allowing this option could be very valuable when an automated procedure does not capture a specific resource's actual costs due to unforeseen market conditions or issues.

The ISO should not raise the penalty price for the power balance constraint to \$2,000.

DMM supports keeping the administrative power balance constraint penalty prices at \$1,000/MWh. Given the ISO's current scheduling and pricing runs, setting prices at the higher of the \$1,000 penalty parameter or cleared verified bids over \$1,000 during a constraint relaxation is

feasible and relatively straight forward. This can be performed while allowing any pre-verified bids over \$1,000/MWh to set prices when the power balance constraint is not relaxed, as required by Order 831.

Raising the penalty price to \$2,000 will significantly affect settlements during periods of administrative pricing. EIM BAAs have more administrative pricing events than the ISO BAA and will be particularly affected by an increased penalty price.

The original purpose of increasing the administrative penalty price to \$2,000 appears to be that the ISO thought it was necessary to allow a \$2,000 per MWh hard bid cap. But raising the administrative penalty prices is not necessary to raise the hard bid cap.

DMM also does not think it makes sense raise the administrative penalty price to \$2,000 in all intervals because the ISO thinks it is needed to accommodate instances with verified bids over \$1,000, which are expected to be rare.

Increasing the penalty price does not increase incentives to bid actual costs.

The proposal asserts that a higher \$2,000 administrative penalty price would improve incentives to bid true costs. As explained in the proposal: ²

Even if a supplier thinks its bid might be the marginal bid, it still has incentive to bid its actual costs because, if there is scarcity, the supplier receives the higher relaxation penalty price.

DMM disagrees with this argument. The ISO will still run a uniform price auction. To the extent there is competition, the uniform price auction design creates incentives to bid true costs regardless of the power balance constraint penalty price. To the extent there is not competition, the power balance constraint's administrative penalty price does not provide an incentive to bid true costs. In fact, DMM is concerned that under non-competitive conditions, raising the penalty price to \$2,000 may encourage physical withholding of supply in order to raise prices from \$1,000/MWh to \$2,000/MWh when no true scarcity exists. Administrative penalty prices are not a substitute for competition.

In the example in the proposal, the supplier's payoffs are simple: "...if a supplier thinks its bid might be the marginal bid..." they would increase their bid above their true cost which will set a higher price when there is not a power balance constraint relaxation. If there is a power balance relaxation, bidding above marginal cost does not hurt the supplier and bidding true costs does not benefit the supplier—they are paid \$2,000/MWh either way. As shown in Figure 1, the higher penalty price does not change the supplier's choice of whether or not to bid true costs — and does not create any additional incentive to bid true cost.

² Straw Proposal, p. 20.

Figure 1. Supplier payoff matrix when no competition

		Outcomes	
		No PBC Violation	PBC Violation
Choice	Bid True Cost	Paid True Cost	Paid \$2000
	Bid Above True Cost	Paid Above True Cost	Paid \$2000

Further, the entire market design envisioned under Order 831 is built on the assumption that the bids over \$1,000/MWh may not represent true costs and that cost verification is necessary to prevent bids from exceeding true costs. As explained in the proposal, in the cases where bids are above \$1,000—which is expected to be rare—the ISO will be verifying the costs *before* the bids go to the market. Since bids over \$1,000/MWh will undergo cost verification, even if a \$2,000 penalty price did create an incentive to bid their true costs (as asserted by the ISO), this would have no impact on final cost-verified bids used in the market.

The ISO should address the problems with non-resource specific resource adequacy imports directly in its resource adequacy initiatives, not by raising administrative penalty prices to \$2,000 in the real-time market.

The proposal also asserts that a \$2,000 penalty prices when almost all bids are capped at \$1,000 will create greater “incentives” to deliver day-ahead schedules.³ The ISO contends that by having potential buy-back costs in the real-time market set by administrative penalty prices that exceed what suppliers are allowed to bid is better “incentive” to deliver day-ahead schedules.

The proposal specifically points to the problem that imports with resource adequacy contracts, but no actual capacity, can bid \$1,000 into the day-ahead market and face no market repercussions for not delivering in real-time even if they clear the day-ahead market. While the proposal points to a real issue with import resource adequacy, raising the administrative penalty prices to \$2,000 is not a direct or particularly effective way of trying to fix this problem.

For example, in 2017 and 2018 power balance violations never exceeding 0.4% of 15-minute market intervals in any quarter. Most quarters were had well below 0.2% of intervals with a power balance violation.⁴ For a resource adequacy import that cannot deliver in real-time to actually face this cost in any hour, the following conditions would have to occur:

- (1) The resource would have its \$1,000 bid clear the day-ahead market, and
- (2) The power balance constraint would need to be relaxed for more than half the 15-minute market intervals in that hour (i.e. 3 or 4 of the 15-minute intervals in that hour).

³ Straw Proposal, p. 21

⁴ Department of Market Monitoring *2018 Annual Report on Market Issues and Performance*, pp. 90.

The probability of both these occurring is so low that these imports would not face a cost anywhere near the benefits of selling resource adequacy contracts not backed by actual capacity.

The ISO should address the problems with non-resource specific resource adequacy imports directly in its resource adequacy initiatives, not by making adjustments to administrative penalty prices in the real-time market.

If the ISO wants to address scarcity pricing it should be done in a separate initiative.

The proposal asserts that there could be benefits to changing the administrative power balance constraint penalty price. The original reason the ISO proposed increasing the penalty price to \$2,000 was they thought it was necessary to increase the hard bid cap to comply with Order 831. But changing the penalty price is not necessary to comply with Order 831. Changes to the penalty price to address issues around scarcity pricing should be handled in an initiative specifically on scarcity pricing. Scarcity pricing is a larger issue than what is discussed in this initiative meant to address Order 831 compliance. A separate scarcity pricing initiative would allow a fuller vetting of the issue.