UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Exelon Generation Company, LLC) Docket No. ER21-43-000

COMMENTS OF THE DEPARTMENT OF MARKET MONITORING OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rule 212 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or "Commission"), 18 C.F.R. §§385.212, the Department of Market Monitoring ("DMM"), acting in its capacity as the Independent Market Monitor for the California Independent System Operator Corporation ("CAISO"), submits these comments in the above-captioned proceeding.

I. SUMMARY

In this proceeding, Exelon Generation Company, LLC has submitted a cost justification filing for spot market sales in the Western Electric Coordinating Council ("WECC") outside the California Independent System Operator ("CAISO") markets that exceeded the "soft" cap of $1,000/MWh ("WECC soft offer cap") during August 2020. The filing by Exelon Generation Company, LLC is one of at least 18 that have been made by different entities for bilateral sales over $1,000/MWh in August 2020.[1] The Commission's decisions in all 18 of these cost justification proceedings concerning sales over the WECC soft offer cap in August 2020 will establish important future precedent and market

[1]See filings in ER21-40, ER21-42, ER21-43, ER21-46, ER21-47, ER21-48, ER21-51, ER21-52, ER21-55, ER21-56, ER21-57, ER21-58, ER21-59, ER21-60, ER21-61, ER21-62, ER21-64, and ER21-65.

expectations in bilateral markets throughout the WECC and the CAISO's organized day-ahead and real-time energy markets.

Consequently, DMM recommends that the Commission develop and provide clear guidance and precedent on what constitutes valid cost justification, regardless of the Commission's ultimate decision in the immediate proceedings. DMM recommends that before the Commission approve any non-generator costs as valid cost justification, the Commission first allow for a comprehensive and thorough review process that includes consideration of the implications of such decisions in these dockets on market power mitigation in CAISO and the rest of WECC.

The Commission has noted that it "cannot anticipate all of the possible bases on which a supplier may seek to justify exceeding the WECC soft energy price cap" and has accordingly declined to define the justification required.[2] Guidance provided by FERC staff relating to these proceedings regarding how sellers could submit to justify sales above that cap has been limited to physical supply resources (generators).[3] However, all of the filings for sales above the soft cap in August 2020 appear to be based on non-generator costs (e.g., the price of purchased energy from an unspecified generating source, perceived regional market prices, costs associated with risk of curtailment, or other non-generation transaction costs). FERC should not validate these justifications without first conducting a comprehensive and thorough review process which explicitly addresses the host of issues associated with cost justifications submitted on a non-generator cost basis. In the event the Commission determines that

[2] *Western Elec. Coordinating Council*, 133 FERC ¶ 61, 026, at P 16 (2010) .
[3] https://www.ferc.gov/industries-data/electric/power-sales-and-markets/staff-guidance-wecc-soft-offer-caps

a purchase from another entity can serve as the cost-basis for sales over $1,000/MWh, DMM respectfully requests the Commission clarify a variety of specific issues related to such an approach which arise in different cost justification filings made for sales above the $1,000/MWh soft offer cap in August 2020, as discussed in these comments.

DMM recognizes the complexity of issues facing the Commission in these proceedings for energy markets throughout the west under tight market and system conditions. However, DMM is concerned that accepting cost-justification for sales over the $1,000/MWh soft cap simply based on a seller's reported purchase price or its assessment of "prevailing market prices" or conditions would essentially render the soft cap meaningless -- and undermine market power mitigation provisions in the CAISO markets. Moreover, any criteria adopted by the Commission in these proceedings (and subsequently by the CAISO) could even create adverse incentives for some participants to circumvent market power mitigation measures approved by the Commission in the CAISO and the rest of the WECC (e.g. through various forms of "megawatt laundering", wash trades, etc.)

Finally, due to the significant broader market impacts that bilateral bids and trades at prices in excess of the WECC soft cap can have, DMM requests that the Commission perform its own comprehensive review of information submitted in all of these proceedings, along with other sources of relevant (and often confidential) information which the Commission may have access to or acquire. As explained in the following sections of these comments, bilateral price indices reported for Western trading hubs are utilized in numerous ways which greatly magnify the impact of these indices on the broader bilateral markets, the CAISO markets and the Western Energy

Imbalance Market. The Commission is uniquely authorized to review energy trades over the $1,000/MWh WECC soft cap in order to ensure the integrity of these bilateral price indices and avoid detrimental impacts on the broader energy markets in the west.

II. COMMENTS

The Commission should address justification of costs on a non - generator cost basis (e.g. purchased power from a non-resource specific source)

In the absence of precedent, and given the expedited process requested by the Commission, the Commission placed no limitations on the type of documentation submitted to justify sales over the $1,000/MWh soft offer cap. None of the August 2020 cost justification filings cited any actual generation costs over $1,000/MWh. Many of the cost justification filings for August 2020 WECC sales over the $1,000/MWh soft offer cap cite negotiated prices among counterparties at prevailing market prices, evidenced by bilateral index prices and CAISO export prices.

The ability of the Commission and interested parties to review all of this information (along with other potential sources of data) provides a valuable opportunity to clarify and establish principles, criteria and expectations that will shape future trading, bidding and cost-review in bilateral markets and the CAISO's day-ahead and real-time markets. DMM believes that clarifying the standard of generation cost to support sales over $1,000/MWh would most effectively preserve the role of the WECC soft offer cap as a market power mitigation measure. Reliance on bilateral indices and "prevailing prices" to justify sales over the soft cap highlights the importance of having transparent bilateral market signals and establishing clear expectations of the conditions under which a sale price over the WECC soft offer cap will be acceptable to the Commission. Guidance which establishes the expectation that the only

transactions over $1,000/MWh should be those that can show supporting documentation of generation cost over $1,000/MWh would clarify that an index price over $1,000/MWh is not a prevailing market price, and thus should not by itself be acceptable justification for sales over the soft offer cap.

If a bilateral purchase may be used as a cost justification for a sale above $1,000/MWh, DMM respectfully requests that the Commission clarify numerous other specific issues.

In the event the Commission determines that a purchase from another entity can serve as the cost-basis for sales over $1,000/MWh, DMM requests the Commission clarify the following issues, all of which appear to arise in various cost justifications filings filed for sales above the $1,000/MWh soft offer cap in August 2020.

- Can a seller simply cite “prevailing market prices” or bilateral price indices as cost justification?
- Can a seller justify costs based on the actual, expected or potential cost of exports purchased from the CAISO?
- Can the counterparty from whom the power was purchased be an affiliated entity? If power is purchased from an affiliated entity, is the mutually agreed upon price a suitable basis for cost justification above the $1,000/MWh cap?
- Can a seller justify the cost on the basis it is acting as a sleeve for another seller?
- In cases when the sales cost over $1,000/MWh exceeds the purchase price, what is the appropriate level and nature of any markup above cost? Can a service or transaction fee be included in addition to the purchase price as cost

justification? Can costs over $1,000/MWh be justified by risk of curtailment or non-delivery?

- What if cost-justification for the sale price of a transaction over $1,000/MWh is not accepted, and that transaction is cited by another seller as the cost-basis for another sale at a price over $1,000/MWh?
- Can a seller justify costs based on purchases from sellers who do not submit cost-justification?
- Must the counterparty from whom the power was purchased be a jurisdictional entity? If power is purchased from a non-jurisdictional entity, is there a basis to request cost justification from the non-jurisdictional entity if the purchase price is above $1,000/MWh?

DMM recognizes the complexity of these issues and the impact that the Commission's determination will have on energy markets throughout the west under tight market and system conditions. However, DMM is concerned that accepting cost-justification for sales over the $1,000/MWh soft cap simply based on a seller's reported purchase price or its assessment of "prevailing market prices" or conditions would essentially render the soft cap meaningless – and undermine market power mitigation provisions in the CAISO markets. Moreover, any criteria adopted by the Commission in these proceedings (and subsequently by the CAISO) could even create adverse incentives for some participants to circumvent market power

mitigation measures approved by the Commission in the CAISO and the rest of the WECC (e.g. through various forms of "megawatt laundering", wash trades, etc.)

CAISO export prices should not justify WECC sales over the $1,000/MWh soft cap.

Some of the submitted cost justification filings for sales over the $1,000/MWh WECC soft offer cap directly cite realized or expected prices of CAISO exports as justification for the sale over $1,000/MWh. Although CAISO prices can exceed $1,000/MWh with congestion and administrative pricing outcomes, CAISO energy bids cannot exceed $1,000/MWh. Therefore, CAISO prices in excess of $1,000/MWh cannot be set by an energy bid and cannot be reflective of the highest cost generation backing the export and thus should not be interpreted as generation cost. Because of this, DMM recommends that realized or expected CAISO export prices over $1,000/MWh not be an acceptable justification of non-CAISO WECC bilateral sales over $1,000/MWh.

There is evidence among the cost justification filings for August 2020 WECC sales over $1,000/MWh that exports were self-scheduled out of CAISO for bilateral resale at prices potentially expected to be over $1,000/MWh. For example, the filing of Brookfield Renewable Trading and Marketing ("BRTM") in Docket ER21-59 states:[4]

> BRTM notes that for most of the Reportable Transactions (9 out of 13) the associated purchases included purchases from CAISO, all of which were self-scheduled exports priced under the CAISO tariff at the locational marginal price, or from a counterparty at index with an adder. BRTM was a price-taker with respect to all the CAISO purchases and all purchases from a counterparty at index with an adder. Therefore, the sale prices of the Reportable Transactions associated with those purchases reflect, in part, the risk that BRTM took in committing day ahead to sell to a counterparty a peak energy product at a fixed price without the ability to know the cost of power at the time of the sale, because BRTM was a price-taker.

[4] *Justification of Spot Market Sales above Western Electricity Coordinating Council Soft Cap of Brookfield Renewable Trading and Marketing*, ER21-59, October 7, 2020.

Self-scheduled CAISO exports reflect a willingness to purchase energy from the CAISO market as a price taker, including at prices exceeding CAISO's $1,000/MWh energy bid cap. An energy marketer's willingness to pay more than $1,000/MWh through a CAISO self-scheduled export may reflect expectation of bilateral resale above the WECC soft offer cap of $1,000/MWh, where the sale price is justified by CAISO export prices exceeding that value in some hours.

Clear guidance that CAISO export prices cannot justify WECC bilateral sales over the WECC soft offer cap and CAISO energy bid cap of $1,000/MWh will decrease the incentive for self-scheduling exports out of CAISO for purposes of bilateral resale. Under this expectation, entities would instead be expected to submit export bids in the CAISO market up to the $1,000/MWh energy bid cap, which reflects both the maximum CAISO generation cost and the WECC soft offer cap.

Many on-peak bilateral transactions cover multiple hours, where the strip bilateral price reflects an average hourly price. Because CAISO prices vary at least hourly and may not exceed $1,000/MWh for all hours of a bilateral strip transaction, the bilateral sale of a strip of energy sourced from CAISO could remain profitable at a sale price of $1,000/MWh or below, even if the cost of procuring a few hours of energy in the strip exceeds $1,000/MWh. Therefore, the change in incentives to self-scheduling of CAISO exports would be most impactful for hourly bilateral transactions, or perhaps shorter super-peak hour block transactions, sourced from CAISO self-scheduled exports.

The change in expectations that would decrease incentives for self-scheduling of exports out of CAISO is particularly important when CAISO prices actually exceed the $1,000/MWh. CAISO export prices in excess of $1,000/MWh are typically indicative of

strained CAISO system conditions, under which no economic exports clear the CAISO market. Particularly in the CAISO day-ahead market, such instances are very rare and indicate extremely tight CAISO supply conditions. Therefore, in addition to the point that CAISO prices above $1,000/MWh cannot represent the cost of a CAISO generator, ensuring that CAISO prices cannot be used as justification for bilateral sales over $1,000/MWh can potentially reinforce the future reliability of the CAISO balancing area. This added reliability is achieved by reduced incentives to self-schedule exports that may be supported by CAISO Resource Adequacy capacity.

To the extent that marketers and other balancing areas in WECC may depend on day-ahead or spot energy purchases under extreme conditions – including energy potentially sourced through self-scheduled exports from the CAISO market when CAISO may be facing similarly extreme conditions -- a firmly enforced soft-offer cap should clarify expectations of the availability of this supply in the future. In this way, the clarified expectation will also contribute to increased long-term reliability in other areas of the WECC by informing future energy procurement and capacity planning in areas outside of CAISO.

Bilateral market prices may not be representative of actual market conditions

The interaction of organized and bilateral market prices for electricity is widely recognized. This inter-relationship is particularly important in the western energy markets since the CAISO operates the only organized markets, with a large volume of transactions occurring at bilateral trading hubs across the west. Prices in regional bilateral hubs can affect prices in the CAISO markets -- and vice versa.

In addition, bilateral price indices for day-ahead trading at hubs in other parts of the west are directly used in the CAISO as an input to the formulas used to set default energy

bids for many limited energy resources in the Western Energy Imbalance Market. These day-ahead price indices are used along with reported prices for longer-term bilateral transactions (e.g. balance-of-month and monthly futures prices) as a proxy for estimating potential opportunity costs of hydro resources energy with storage capacity. Thus, bilateral trades in excess of the WECC soft cap which are reported at different western trading hubs can ultimately result in extremely high default energy bids for resources in the Western Energy Imbalance Market.

Due to the potential direct and indirect effects of bilateral market indices on prices in the CAISO and Western Energy Imbalance Market, DMM encourages the Commission to carefully scrutinize transactions and conditions leading to extremely high prices in excess of the soft cap which play a role in setting these bilateral price indices. Available data on bilateral market prices and transactions at the Palo Verde trading hub during the August 18-19 period illustrate the need for such scrutiny.

Figure 1 shows bilateral day ahead market price indices for peak power at the Palo Verde trading hub and the major trading hub in nearby Southern California (SP15) from August 13 to 21. As shown in Figure 1, price indices for the Palo Verde trading hub reported by ICE and SNL both tend to be highly correlated with bilateral prices for ICE trades at SP15. DMM understands that the SNL price index represents a weighted average that includes ICE trades along with other bilateral market trades. However, on August 18 both the ICE and SNL indices both rose to about $1,300/MWh compared to about $600/MWh at SP15. On August 19, the Palo Verde price index reported by ICE remained over $1,300/MWh while the index for SNL dropped to about $200/MWh.

Figure 1. Day-ahead prices (Peak hours 7-22)

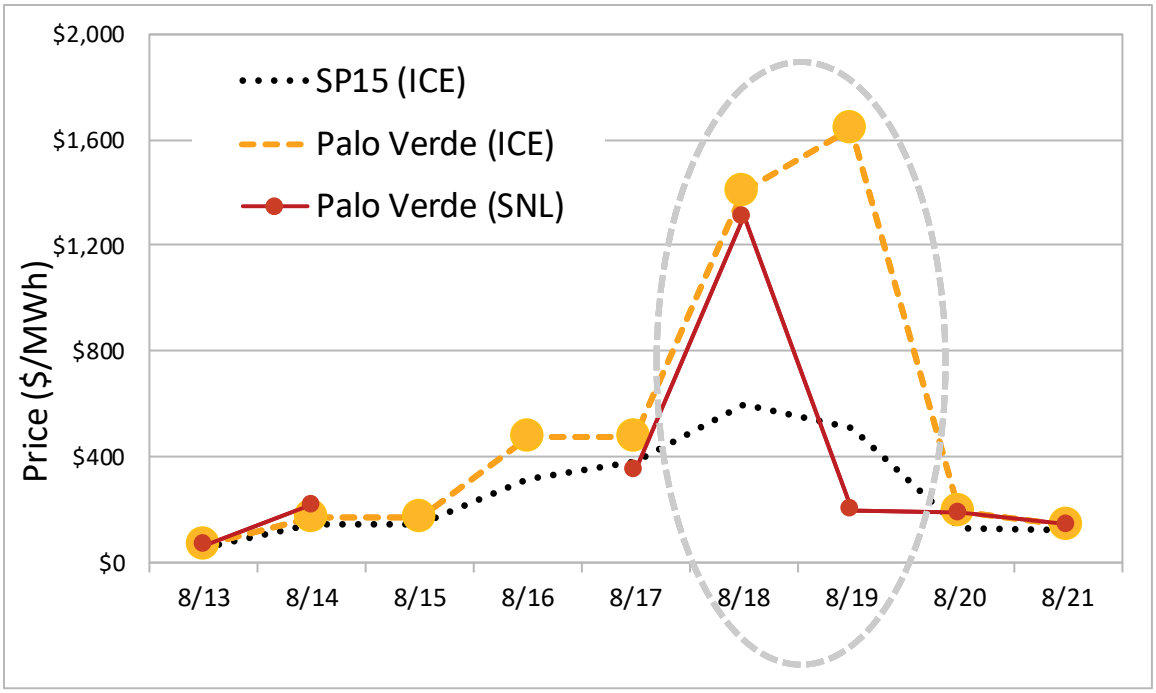
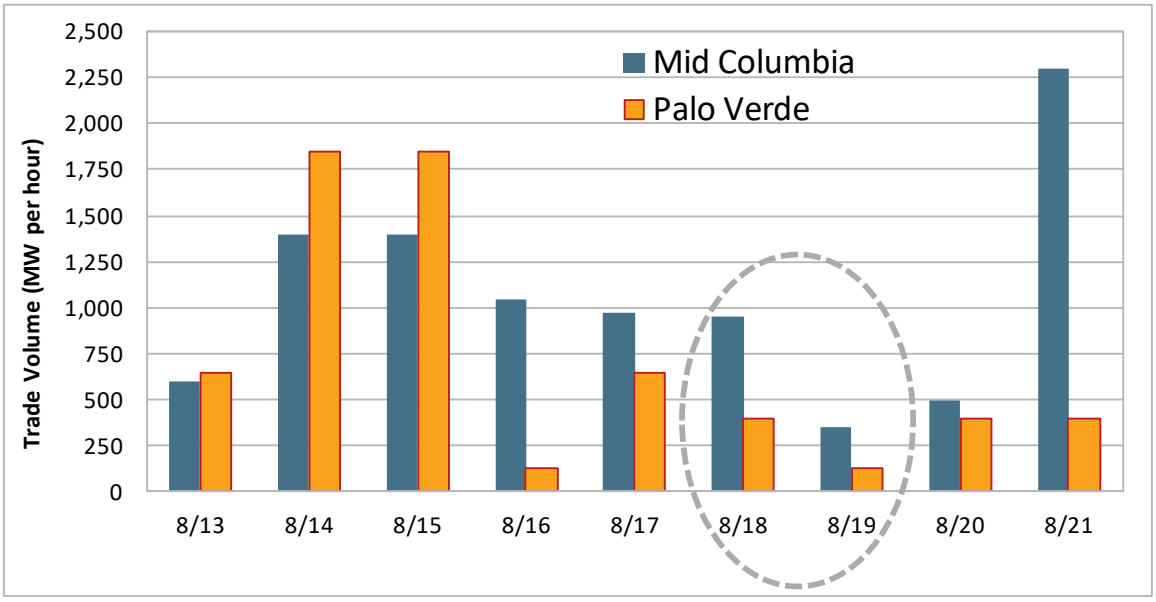


Figure 2. Day-ahead market volumes (ICE, Peak hours 7-22)



As shown in Figure 2, the ICE day-ahead bilateral market price index for peak power trades at Palo Verde on August 18 and 19 was based on a relatively small trading volume (400 MW per hour on August 18 and only 125 MW per hour on August 19). The number of trades and entities transacting on ICE for power at Palo Verde was also very low on these days. These data suggests that the market for day–ahead peak energy at Palo Verde on ICE was quite limited and potentially illiquid. In addition, the much lower weighted average price reported by SNL for August 19 suggests that, on that day, trades on ICE were not representative of overall bilateral market prices on that day.

Counterparties trading in WECC may interpret bilateral index prices as a readily available indicator of prevailing market prices. While the bilateral indices may be among the best available indicators of WECC bilateral market conditions, these indices may not always represent broader WECC trading activity. This point is emphasized in the cost justification filing of Shell Energy North America submitted October 7, 2020 in Docket ER21-57:[5]

> Even though [bilateral index prices on August 18-19, 2020] were set by low volumes and few trades, those index prices were actually used in numerous bilateral transactions, including transactions priced at the index (or index plus an adder or minus a discount). Regardless of the strength of the price formation process, index prices are therefore reasonable proxies for the cost of traded products and the replacement cost that sellers may face at certain trading locations. In fact, at times of price volatility some market participants may choose to trade index products rather than entering into fixed price transactions…"

DMM believes these data illustrate the need for the Commission to carefully scrutinize transactions and conditions leading to extremely high prices in excess of the soft cap at the Palo Verde trading hub on August 18 and 19. For the immediate proceeding,

[5] *Spot Market Sales above Soft Cap of Shell Energy North America (US), L.P*, ER21-57, October 7, 2020.

DMM encourages the Commission to carefully scrutinize the transactions that established the extremely high bilateral index prices of August 18-19, 2020.

IV. CONCLUSION

DMM recommends that the Commission develop and provide clear guidance and precedent on what constitutes valid cost justification, regardless of the Commission's ultimate decision in the immediate proceedings. DMM recommends that before the Commission approve any non-generator costs as valid cost justification, the Commission should first provide for a comprehensive and thorough review process for consideration of the implications of such a decision on market power mitigation in CAISO and the rest of WECC.

In the event the Commission determines that a purchase from another entity can serve as the cost-basis for sales over $1,000/MWh, DMM respectfully requests the Commission clarify a variety of specific issues related to such an approach which arise in different cost justification filings made in the current proceedings.

DMM respectfully requests that the Commission afford due consideration to these comments as it evaluates the cost justification filings before it for non-CAISO WECC sales exceeding the $1,000/MWh soft offer cap.

Respectfully submitted,

By: *<u>/s/ Adam Swadley</u>*

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Dated: October 28, 2020

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 28th day of October, 2020.

/s/ Candace McCown

Candace McCown