

Comments on Price Formation Enhancements September 14, 2023 Working Group

Department of Market Monitoring

October 4, 2023

The Department of Market Monitoring (DMM) appreciates the opportunity to comment on the *Price Formation Enhancements September 14, 2023 Working Group*.¹

DMM continues to support enhancements to the balancing authority area (BAA)-level market power mitigation process that exists in the Western Imbalance Energy Market (WEIM), and which the ISO will implement in the Extended Day-Ahead Market (EDAM). BAA-level mitigation protects areas from the potential exercise of market power whenever transfer constraints bind and create local areas within the larger system. The two enhancements discussed include subjecting the CAISO balancing area to BAA-level mitigation and introducing a grouping mechanism for testing the competitiveness of groups of BAAs.

DMM supports treating the CAISO BAA similarly to other WEIM/EDAM BAAs by subjecting the CAISO to BAA-level mitigation if the CAISO BAA is deemed uncompetitive on its own, or as part of a group with other BAAs. Enhanced market power mitigation procedures should not assume the CAISO BAA is always structurally competitive. In 2022, there were 130 hours where the residual supply index in the CAISO day-ahead market was below one, indicating an uncompetitive level of supply.² While the CAISO BAA may not be structurally uncompetitive frequently, this can change over time depending on a number of conditions. For example, the competitiveness of the CAISO BAA may decrease as the amount of load served by major investor-owned utilities decreases more than the amount of generation controlled by these utilities. Thus, DMM supports enhancing market power mitigation mechanisms in order to address hours when supply in the CAISO BAA is uncompetitive.

DMM also supports implementing a grouping mechanism to test the competitiveness of groups of multiple BAAs. This would be an improvement over the current WEIM and EDAM policy of only testing each BAA individually. An individual BAA may be non-competitive when tested individually, but it may be part of a larger group of balancing areas which, when considered together, would be a competitive area. Testing BAAs together, rather than just individually, may reveal that the group as a whole is competitive and avoid unnecessarily subjecting individual non-competitive BAAs to mitigation.

The exact method of grouping for assessing and mitigating potential market power in groups of BAAs requires further discussion and evaluation. The ISO proposed a design in its July 2022 Price Formation Enhancements Issue Paper.³ The ISO's proposal groups BAAs in descending order of their power balance

¹ *Price Formation Enhancements – Working Group Session #4*, CAISO, September 14, 2023:

<http://www.caiso.com/InitiativeDocuments/Presentation-Price-Formation-Enhancements-Sep14-2023.pdf>

² 2022 Annual Report on Market Issues and Performance, July 11 2023, pp. 154-156:

<http://www.caiso.com/Documents/2022-Annual-Report-on-Market-Issues-and-Performance-Jul-11-2023.pdf>

³ *Price Formation Enhancements – Issue Paper*, CAISO, July 5, 2022, pp. 19-23: [Issue-Paper-Price-Formation-Enhancements.pdf \(caiso.com\)](https://www.caiso.com/InitiativeDocuments/Issue-Paper-Price-Formation-Enhancements.pdf)

shadow prices and tests groups until a competitive group is found and deems all the remaining BAAs/group of BAAs with lower shadow prices as competitive. This method would allow significant gaps in the detection and mitigation of the exercise of market power.

One issue with this design is that if an area has competitive supply but significantly higher actual costs than other areas, supply in the rest of EDAM/WEIM could exercise market power up to the level of the high costs in that area. In addition, a dominant entity in a BAA may have incentive to take advantage of this design to undermine BAA-level mitigation in the rest of EDAM/WEIM. Specifically, under this design a vertically integrated utility deemed competitive on its own may have an incentive to inflate its own prices in order to eliminate mitigation in the other BAAs. This would in turn inflate average prices in the rest of EDAM/WEIM and increase the expectation for higher future prices. The marketer for the vertically integrated utility could profit from creating higher expected prices in other EDAM/WEIM areas by making bilateral export sales at the inflated expected prices. The exact details of how the ISO's proposed design could allow the exercise of market power would depend on details such as what the ISO would consider supply of counterflow and how the design would treat non-transfer exports.⁴

In previous comments, DMM described a potential alternative grouping mechanism for BAA-level market power mitigation.⁵ DMM recognizes that this potential alternative approach could result in potential over- or under-mitigation in some situations. However, it has some merits relative to the approach proposed in the ISO's Issue Paper. DMM looks forward to discussions about alternatives to the ISO's Issue Paper mitigation proposal, and hopes the alternative we described can contribute to those discussions.

⁴ DMM Comments on Price Formation Enhancements Issue Paper, August 11, 2022, pp. 4-6:
<http://www.caiso.com/Documents/DMM-Comments-Price-Formation-Enhancements-Issue-Paper-Aug-11-2022.pdf>

⁵ Ibid, pp. 7-9.