JOINT PARTY COMMENTS
COMMITMENT COSTS AND DEFAULT ENERGY BID
DRAFT TARIFF LANGUAGE

May 28, 2019

On May 10, the CAISO posted draft tariff language associated with the Commitment Costs and Default Energy Bid Enhancement and FERC Order No. 831 Compliance initiative. NV Energy, PacifiCorp, Idaho Power, Portland General Electric, and Arizona Public Service ("Joint Parties") offer these comments in opposition to the proposed 100% increase to the power balance constraint penalty price which is unsupported, unjust and unreasonable, inconsistent with the CAISO's prior commitments to FERC, and not required by Order No. 831. Additionally, the Joint Parties submit these comments to request additional specifications be provided in the tariff for the documentation needed for a reference level adjustment.

A. Reference Level Adjustment Documentation Requirement

In section 30.11.2.2 of the draft tariff language, CAISO states that a reference level adjustment must be supported by Documentation of Contemporaneously Available Information. This statement does not provide enough information about the types of documents or supporting information that would be suitable to CAISO when submitting a reference level adjustment. Therefore, the Joint Parties request that CAISO provide more detail or examples about the type of documentation that would be deemed suitable for a reference level adjustment.

B. Use of the $2,000 Hard Cap Level for the Power Balance Constraint Penalty Price Is Unjust and Unreasonable

Currently, section 27.4.3.2 and the second sentence of section 27.4.3.4 of the CAISO Tariff establish the power balance penalty price at $1,000/MWh in circumstances where the CAISO's market clearing software must relieve transmission constraints or system energy-balance shortages to clear the market. This is accomplished by reference to the Energy Bid Cap in section 39.6.1.1. In the draft tariff language, the CAISO proposes to reference a new term "Hard Energy Bid Cap" which is defined as "the maximum Energy Bid Price the CAISO will use for purposes of clearing the CAISO Market Process. The Hard Energy Bid Cap is $2000 per MWh."

In accordance with Order No. 831, however, any supply offer above the current energy bid cap of $1,000/MWh will require cost-based justification to be just and reasonable. Without this factual demonstration, the energy bid cap remains at $1,000/MWh. Nevertheless, the CAISO proposes to use $2,000/MWh as the power balance constraint parameter penalty price in all hours, omitting the cost-based justification. As explained below, the CAISO's proposal fails to withstand scrutiny. The current $1,000/MWh power balance constraint parameter penalty price should be retained, at least for the overwhelming majority of intervals where there is no cost-justified bid above $1,000/MWh.

On November 17, 2016, FERC issued Order No. 831,[1] requiring that each regional transmission organization and independent system operator: (1) cap each resource's incremental energy offer at the higher of $1,000/MWh or that resource's verified cost-based incremental energy offer; and (2) cap verified cost-based incremental energy offers at $2,000/MWh when calculating locational marginal prices ("LMPs").[2] The $2,000/MWh level was chosen by FERC based in part on a $1,724/MWh energy offer during the polar vortex in the winter of 2013/14.[3]

A critical component of Order No. 831 is that in order to be just and reasonable, energy offers above $1,000/MWh must be cost justified. The CAISO has recognized the importance of this cost-justification process and proposed extending it to imports as well as internal resources.[4] Nothing in Order No. 831 states that the $2,000/MWh level was intended to be utilized as a penalty price or indication of scarcity 8,760 hours per year. Indeed, FERC stated that under limited extreme circumstances "resources may experience costs that approach but are unlikely to exceed $2,000/MWh."[5]

In its draft tariff language, the CAISO takes a pricing provision that must be cost-justified under very specific conditions and makes it a generally-applicable price to be used for modeling insufficiencies at all times. The CAISO did so despite its own statements:

- There is no evidence indicating that incremental costs in the CAISO markets have approached the current $1000/MWh cap.

- The CAISO has previously stated, and continues to believe, that the current hard cap is sufficient for the CAISO markets because $1,000/MWh is far in excess of what the highest reasonable cost-justified offer could be from a resource in the CAISO generation fleet.

- The CAISO appreciates that gas market fundamentals may change over time or that unforeseen events may occur that might raise the costs of incremental energy for a generator above $1,000/MWh, but the record of this proceeding contains no evidence that those conditions have occurred or have almost occurred in the

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1 *Offer Caps in Markets Operated by Regional Transmission Organizations and Independent System Operators*, Order No. 831, 157 FERC ¶ 61,115 (2016) ("Order No. 831").

2 *Id.* P 1. For an incremental energy offer equal to or above $1,000/MWh and less than or equal to $2,000/MWh, the RTO/ISO or Market Monitoring Unit must verify that the offer is cost-based before the RTO/ISO may use the offer to calculate LMPs. *Id.* P 78.

3 *Id.* P 90.

4 *See* CAISO, ISSUE PAPER AND STRAW PROPOSAL – IMPORT BID COST VERIFICATION (May 10, 2019), *available at* http://www.caiso.com/informed/Pages/StakeholderProcesses/ImportBidCostVerification.aspx.

5 Order No. 831 at P 90.

CAISO's market. Even if the fundamentals were to change, the CAISO believes such events would be infrequent and short-lived and do not justify the changes the CAISO would have to make to allow market participants to bid in above the soft bid-cap based on cost-verified bids.

- It is not clear to the CAISO that it would be appropriate for scarcity pricing and these other market parameters to float dynamically along with the cap.[6]

Under FERC and federal court precedent, any non-cost-based incentive or penalty must be needed and no more than needed for the intended purpose.[7] The CAISO has not made a case for the required linking of a cost-justified bid level to a modification of the power balance constraint parameter penalty price.

C. If the CAISO Has Implementation Challenges Associated with Use of a "Soft Cap" Between $1,000 and $2,000, the Just and Reasonable Approach Would Be to Maintain the $1,000 Level

In its April 4, 2016 comments in Docket No. RM16-5, CAISO stated,

> At this time, the CAISO believes it would face significant challenges in dealing with a "floating" offer cap. Any direction to modify the CAISO's offer cap must account for these factors and provide for sufficient time to design and implement changes to the CAISO's market rules. Because, the ISO has not yet even confirmed whether a feasible way to do this even exists, FERC should balance these implementation concerns against how often it expects to see costs above $1,000/MWh in the CAISO market. Setting the cap at a higher level, *e.g.*, $2,000/MWh, may also have related adverse effects.[8]

The CAISO went on to consider *and immediately reject* the very approach reflected in the draft tariff provisions – setting the power balance constraint parameter penalty price at $2,000/MWh at all times.

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[6] CAISO, Comments, Docket No. RM16-5-000, at 2, 4–5, 14 (filed Apr. 4, 2016) (citations omitted) ("CAISO Comments").

[7] *City of Detroit v. Fed. Power Comm'n*, 230 F.2d 810, 817 (D.C. Cir. 1955), *cert. denied sub nom., Panhandle E. Pipe Line Co. v. City of Detroit*, 352 U.S. 829 (1956) ("*City of Detroit*"); *see also Farmers Union Cent. Exch. Inc. v FERC*, 734 F.2d 1486, 1503 (D.C. Cir. 1984) ("FERC failed to forecast or otherwise estimate the dimensions of the need for additional capacity, and did not even attempt to calibrate the relationship between increased rates and the attraction of new capital."); *City of Charlottesville v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1981) (citing *City of Detroit*); *Pub. Serv. Comm'n of N.Y. v. FERC*, 589 F.2d 542, 552–53 (D.C. Cir. 1978). The Commission recognized this requirement in its 1992 Policy Statement on incentive ratemaking which stated, the Commission "is free to set rates [above cost-based rates] to provide incentives so long as there is a correlation between the incentive and the result to be induced." *Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities*, 61 FERC ¶ 61,168, at 61,594 (1992) (citation omitted).

[8] CAISO Comments at 15–16.

> Although setting the cap at $2,000/MWh, rather than having a $1,000/MWh soft cap, would avoid having to update the penalty prices if the ISO accepted a bid above $1,000/MWh, it would result in the penalty prices not functioning appropriately because they would be set contemplating bids up to $2,000/MWh when bids would be much less than $1,000/MWh the vast majority of the time.[9]

The CAISO's own words are precisely the concern being expressed in these comments – use of a $2,000 parameter penalty price results ***in the penalty prices not functioning appropriately.***

D. Use of a $2,000 Hard Cap Level for the Power Balance Constraint Penalty Price Is Even More Problematic as Applied to EIM Entities

Setting the power balance constraint parameter penalty price at $2,000/MWh at all times is especially inappropriate as applied to the Energy Imbalance Market ("EIM") where the CAISO committed to FERC to engage in a stakeholder process to consider lowering the current $1,000/MWh level. Now, instead of lowering the penalty, CAISO proposes to double it.

After PacifiCorp began participating in the Energy Imbalance Market on November 1, 2014, certain transitional conditions arose that restricted the timing and amount of capacity available through the market clearing process. These conditions caused the transmission and system energy-balance constraints described in the CAISO Tariff to bind more frequently than expected, producing atypically high prices in the fifteen-minute and five-minute markets in the PacifiCorp balancing authority areas. As a result, on November 13, 2014, CAISO filed in Docket No. ER15-402-000 a petition seeking limited waiver of the pricing parameters. In several subsequent orders, the Commission granted limited extensions of the waiver of the pricing parameters.[10]

On April 9, 2015, Commission staff held a technical conference to discuss issues related to the underlying causes of the price spikes. During the April 9, 2015 technical conference, the CAISO introduced testimony from Scott Harvey, a member of the CAISO Market Surveillance Committee. Mr. Harvey explained that other RTOs have also addressed the need to relax modeling constraints when faced with the need to balance the system on a five-minute basis using economic bids. The values identified for the Midcontinent Independent System Operator, Inc. and the New York Independent System Operator, Inc. ("New York ISO") were substantially below the $1,000/MWh parameter penalty price.[11] During the conference, the CAISO also testified, "[t]hose parameters were designed for the California ISO system" and, "At least from the perspective of the EIM application of that parameter, at this point it may not be the right parameter to use . . . ."[12]

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[9] *Id.* at 16.

[10] *Cal. Indep. Sys. Operator Corp.*, 149 FERC ¶ 61,194 (2014); *Cal. Indep. Sys. Operator Corp.*, 150 FERC ¶ 61,086 (2015). The CAISO sought a waiver for the first weeks of the EIM in Docket No. ER15-817.

[11] *Cal. Indep. Sys. Operator Corp.*, Transcript of April 9, 2015 Technical Conference, Docket Nos. ER15-861-000 and EL15-53-000, at 129–38 (Apr. 9, 2015).

[12] *Id.* at 16–17.

In April 23, 2015 comments, the CAISO set forth conceptual ideas regarding proposed market enhancements to address the EIM price spikes, but did not submit detailed proposed tariff revisions. On May 7, 2015, NV Energy submitted comments supporting the CAISO's approach but also requesting a future stakeholder process that would examine the appropriateness of the $1,000/MWh parameter penalty price applied to the EIM.[13]

In an order issued on July 20, 2015, FERC

> note[d] that CAISO states its intention to explore whether the transmission constraint parameter should be calibrated at different levels, as well as the advantages and disadvantage of reducing the $1,000/MWh parameter price, as part of its planned Stepped Transmission Constraint stakeholder initiative, and encourage[d] CAISO to follow through on its consideration of this potential EIM enhancement.[14]

The CAISO made a Compliance Filing on August 19, 2015 so that the EIM would automatically recognize and account for capacity an entity participating in the EIM has available to maintain reliable operations in its own Balancing Authority Area, but has not bid into the EIM. In its filing letter, the CAISO agreed that stakeholders "can examine this issue as part of the planned Stepped Transmission Constraint initiative, which is expected to begin in the second half of 2015,"[15] and stated,

> Iberdrola and NV Energy request that the CAISO further examine the issue of reducing the $1,000/MWh price cap set forth in its tariff[.] The CAISO and stakeholders can examine this issue as part of the planned Stepped Transmission Constraint initiative, which is expected to begin in the second half of 2015. That stakeholder initiative will consider whether the performance of the transmission constraint parameter could be improved if the CAISO were to calibrate it at different levels depending on either the level of constraint relaxation, the voltage level of the constraint, or the system impact of the constraint. As part of that discussion, the CAISO and stakeholders can also consider the potential advantages and disadvantages of reducing the price cap.[16]

Later, in an order issued December 17, 2015, FERC found:

- NV Energy and PacifiCorp point out that the current $1,000/MWh parameter penalty price was adopted by CAISO for purposes of CAISO's energy market prior to the EIM's implementation. PacifiCorp and NV Energy state that they appreciate that stakeholders will be able to examine this issue as part of CAISO's upcoming Stepped Transmission

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[13] *See* NV Energy, May 7 Initial Comments, Docket Nos. ER15-861-000 and EL15-53-000, at 9–10 (filed May 7, 2015).

[14] *Cal. Indep. Sys. Operator Corp.*, 152 FERC ¶ 61,060, at n.45 (2015).

[15] CAISO, EIM Available Balancing Capacity Compliance Filing, Docket No. ER15-861-003, at 47 (filed Aug. 19, 2015).

[16] *Id.* (citations omitted).

Constraints initiative. NV Energy, PacifiCorp, and Puget support CAISO's commitment to re-examine whether the existing power balance and transmission constraint relaxation rules, which trigger the $1,000/MWh penalty price in one step when there is insufficient supply to address the constraint relaxation, are still appropriate for the remaining small number of intervals in which the EIM results in infeasible solutions.[17]

- CAISO agrees that it is necessary to evaluate whether the existing power balance and transmission constraint relaxation rules are still appropriate, and states that it has already announced its intent to commence a stakeholder process to consider these issues. CAISO further notes that, in addressing the scarcity pricing proposed by the Commission in its September 17, 2015 Notice of Proposed Rulemaking in Docket No. RM15-24-000, it will be required to consider the triggering events in the context of the constraint parameter relaxation changes it is contemplating.[18]

- We find that the level of the penalty price that will apply when an infeasibility occurs is beyond the scope of this proceeding because there is no proposal in front of us to change the existing CAISO tariff provisions regarding the penalty level. However, we note that CAISO has initiated a stakeholder process to investigate CAISO's transmission constraints and we encourage CAISO and its stakeholders to work together to address these concerns.[19]

The CAISO announced its new Stepped Constraint Parameters initiative on May 5, 2016. However, the CAISO abruptly closed the initiative in March 7, 2017, cancelling the stakeholder call scheduled for the next day. The CAISO's market notice stated,

> The Real-Time Market Enhancements initiative, planned for later this year, will include considering co-optimizing ancillary services and energy in the real-time market. This will provide an opportunity to consider if graduated penalty prices are appropriate when there are insufficient energy bids.[20]

The CAISO has not commenced the Real Time Market Enhancement and, based on the most recent Roadmap, will not do so prior to 2020 at the earliest.[21]

As Balancing Authorities, EIM Entities are responsible for maintaining the supply balance within their respective Balancing Authority Areas. Their resource adequacy requirements are determined by their local regulatory authorities through an integrated resource planning process. Limited infeasibilities will not send price signals to modify that process. They

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17 *Cal. Indep. Sys. Operator Corp.*, 153 FERC ¶ 61,305, at P 74 (2015) (citations omitted).

18 *Id*. P 78 (citation omitted).

19 *Id*. P 84 (citation omitted).

20 *Stepped Constraint Parameters: Initiative Closed, 3/8/17 Call Cancelled*, CAISO (Mar. 7, 2017), http://www.caiso.com/Documents/SteppedConstraintParametersInitiativeClosed030817CallCancelled.html.

21 CAISO, 2019 THREE-YEAR POLICY INITIATIVES ROADMAP AND ANNUAL PLAN (Dec. 17, 2018), *available at* http://www.caiso.com/Documents/2019FinalPolicyInitiativesRoadmap.pdf.

will, however, produce unjust and unreasonable prices for that interval if the power balance parameter penalty is set at a price that would not be appropriate, but for a cost-based justification reflective of extreme conditions. The Joint Parties submit that the $2,000/MWh proposed price in section 27.4.3.2 and the second sentence of section 27.4.3.4 is inappropriate for use in the CAISO's own Balancing Authority Area. It is even more problematic as applied to the EIM. The CAISO should withdraw this proposal and investigate the use of stepped parameters *below the $1,000/MWh level*.

E. Implementation of Order No. 831's Requirements Does Not Require an Increase of the Power Balance Constraint Penalty to $2,000

Order No. 831 does mandate the use of the energy bid cap for the power balance constraint penalty price in general and it certainly does not require the use of the hard cap $2,000/MWh level. For example, the New York ISO filed its Order No. 831 compliance filing in Docket No. ER17-1561. The New York ISO did not propose to modify section 15.3.7 establishing the regulation service demand curve[22] and section 15.4.7 establishing the operating reserve demand curves and scarcity reserve demand curve of the New York ISO Market Services Tariff.

F. Conclusion

The Joint Parties apologize for not recognizing the CAISO's proposed change to the power balance constraint parameter penalty price until it was specifically reflected in the draft tariff language. Nevertheless, the Joint Parties respectfully requests that the CAISO consider these comments. Increasing the power balance constraint parameter penalty price above $1,000/MWh will produce unjust and unreasonable prices in almost all, if not all instances, when the constraint is triggered.

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22 N.Y. Indep. Sys. Operator, Inc., NYISO Tariff, OATT, § 15.3.7 ("For quantities of Regulation Capacity that are less than or equal to the target level of Regulation Service minus 80 MW, the price on the Regulation Service demand curve shall be $775/MW. For quantities of Regulation Capacity that are less than or equal to the target level of Regulation Service minus 25 MW but that exceed the target level of Regulation Service minus 80 MW, the price on the Regulation Service demand curve shall be $525/MW. For quantities of Regulation Capacity that are less than or equal to the target level of Regulation Service but that exceed the target level of Regulation Service minus 25 MW, the price on the Regulation Service demand curve shall be $25/MW. For all other quantities, the price on the Regulation Service demand curve shall be $0/MW. However, the ISO shall not schedule more Regulation Service than the target level for the requirement for that hour.").