California ISO

Stakeholder Comments Template

Capacity Procurement Mechanism Soft-Offer Cap

This template has been created for submission of stakeholder comments on Capacity Procurement Mechanism (CPM) Soft-Offer Cap that was published on May 30, 2019. The paper, Stakeholder meeting presentation, and other information related to this initiative may be found on the initiative webpage at: http://www.caiso.com/informed/Pages/StakeholderProcesses/CapacityProcurementMechanismSoft-OfferCap.aspx

Upon completion of this template, please submit it to initiativecomments@caiso.com. Submissions are requested by close of business on July 1, 2019.

Submitted by	Organization	Date Submitted
Jaime Rose Gannon *415-703-2818* *Michele Kito*	*Energy Division (CPUC)*	*July 1, 2019*

Energy Division Staff (hereafter, "ED Staff" or "Staff") supports opening this initiative to update the CPM soft offer cap and review other Capacity Procurement Mechanism (CPM) issues. Staff agrees with the issues currently in scope, including the following:

- Update the soft offer cap for CPM competitive solicitation process;
- Examine compensation and market power mitigation for 12-month CPM designations; and
- Include previous changes developed in the RMR/CPM initiative for CPM bids above the soft offer cap.

In addion to the issues listed above, Staff requests that following items be added to the scope of this initiative:

- Use of the 20% adder used to set the soft offer cap;
- Allocation of flexible capacity benefits for CPM designations; and
- Changes to the cost allocation methodology for annual CPM designations that would address intra-year load migration.

Most of the these issues were discussed in considerable detail in the CAISO's RMR CPM enhancements stakeholder initiative, which concluded with CAISO's April tariff filing. [1] Addressing these backstop mechanism separately limits the CAISO's and stakeholders' ability to holistically assess CAISO's backstop mechanisms and the effect these mechanisms have on the bilateral market. As FERC stated in its order rejecting the CPM ROR tariff (emphasis added):

> [W]e strongly encourage CAISO and stakeholders to make progress in the ongoing stakeholder process and to adopt a holistic, rather than piecemeal, approach. We believe that this should include: (1) revisiting the issue of the adequacy of CPM and RMR compensation; (2) evaluating whether both risk of retirement CPM and RMR need to be retained as separate backstop mechanisms; (3) examining the timeline and eligibility requirements for issuing risk of retirement CPM designations and how those factors may impact bilateral resource adequacy procurement; and (4) evaluating measures that would trigger the review of its backstop procurement if it appears to be overused.[2]

Given CAISO's decision not to address CPM issues in its recent FERC filing, Staff provides comments here that reflect some of the positions already raised in response to the CAISO's RMR CPM enhancements FERC tariff filing.[3]

1. Updating the Soft Offer Cap

Staff does not take a position at this time on the appropriate reference unit to use for the soft offer cap. However, Staff notes that the prior referenced unit was meant to reflect the newest generation coming online (the marginal resource) and, at that time, these units were CCGT facilities with nameplates of ~ 550 MW, with duct firing. The new resources being added to the system for 2020 LCR needs include CCGTs with nameplates of ~600- 640 MW, without duct firing capability (e.g. the Alamitos and Huntington Beach replacements). In addition, preferred new generation resources are expected to come online, as authorized in D.15-11-041[4] and D.18-05-024,[5] and these resources could be considered marginal. These preferred resources include lithion-ion batteries, as well as behind the meter demand response paired with storage. Staff believes the going-forward-fixed-costs (GFFC) of these preferred resources may be significantly less than conventional generation resources. However, Staff recognizes that the CEC's cost of generation model did not include these preferred resource technologies in its 2018 update (probably due to the relatively small number of facilities and limited data available). Staff looks forward to working with the CAISO and stakeholders to determine the appropriate reference unit to use in the soft-offer-cap calculations.

In the CEC's 2018 cost of generation update, it states"Staff found that the costs of gas-fired technologies have remained stable since the previous report, while combined-cycle (CC)

---

[1] ER19-1641-000 March 22, 2019 CAISO Tariff Filing
[2] FERC Docket E-18-641-000 Order rejecting CPM ROR tariff revision Paragraph 48
[3] ER19-1640-000 May 21, 2019 CPUC Protest and Complaint - https://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=15252140
[4] http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M156/K064/156064924.PDF
[5] http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M215/K724/215724114.PDF

technologies increased in capacity. Staff held instant and operations and maintenance costs constant for this update, while increasing the size of CCs."[6]

Since O&M was held constant for the update, Staff reviewed the CEC's 2014 report for additional information on the costs included with O&M and found the following:

> Fixed O&M costs are the costs that occur regardless of how much the plant operates. These costs are not uniformly defined by all interested parties but generally include staffing, overhead and equipment (including leasing), regulatory filings, and miscellaneous direct costs. The first-year cost is provided as an estimate and then escalated by inflation plus 0.5 percent real escalation.[7]

Staff understands that the O&M data was collected from 2012 survey data from existing power plants included in appendix B-2 of the CEC's 2014 report. The data from these plants is categorized into either a capital cost parameter or an Operating & Maintenance cost parameter. The O&M cost parameter includes "normal annual maintence costs, including scheduled overhaul frequency/costs." It is Staff's understanding that these fixed O&M costs include major maintence scheduled over the life of the asset. Thus, it is Staff's understanding that the major maintenance cost are technically covered in GFFC estimates and are not addional costs above the GGFC. Capital additions would include plant improvements to increase efficiency or MWh output of a facility, not maintence to maintain the existing operation of the plant. Staff believes this is an important element to understand to ensure that the soft offer cap is set appropriately.

2. Assessing Payment for 12-Month CPM Designations

Staff does not believe that the current compensation for annual CPM designations is just and reasonable and believes that it is too high because it includes both a 20% adder on a resource's GFFC and allows the resource to retain market revenues. Compensation at this level may result in a fully depreciated generator with market power choosing the CPM path rather than the RMR path to secure a contract.

CPM designations are meant to be obtained through a "competitive solicitation process." However, the two annual designations that occurred in 2017 (for 2018 compliance) were not competitive. Specifically, Encina received a CPM for 545 MW of capacity[8] at the soft offer cap of $6.31/kW-month,[9] but Encina was only unit that could meet this specific local reliability need. Likewise, Moss Landing also received a CPM for all of 2018, for the remaining capacity available

---

[6] Cost of Generation 2018 update Appendix B-22- https://ww2.energy.ca.gov/2019publications/CEC-200-2019-005/CEC-200-2019-005.pdf

[7] CEC 2014 COG study at 144- https://www.energy.ca.gov/2014publications/CEC-200-2014-003/CEC-200-2014-003-SF.pdf

[8] CAISO, "Capacity Procurement Designation on 12/22/17," available at

http://www.caiso.com/Documents/CapacityProcurementMechanismDesignation-122217.html#search=CPM%20Encina

[9] CAISO, "December 22, 2018 Year Ahead Local CPM Designation Report," available at http://www.caiso.com/Documents/December222017YearAheadLocalCPMDesignationReport.pdf.

on the units (i.e., 510 MWs)[10] and received a price of \$6.19/kW-month for 490 MW and the soft offer cap price of \$6.31 per kW month for the remaining 20 MW,[11] but this was the only resource that could meet the specific Bay Area local reliability need identified by the CAISO.

Both of the annual CPM designations listed above were for significantly depreciated generators. Paying them the GFFC plus a 20 percent adder (in addition to net market revenues) could potentially incentivize resources with market power to utilize the CPM mechanism rather than participate in the bilateral market because the capacity prices at the CPM soft offer cap are potentially more lucrative.

In order to address market power concerns associated with CPM designations (especially annual designations), Staff proposes the elimination of the 20 percent adder. This will align the soft offer cap with prices in the bilateral market and mitigate withholding and market power concerns that have been raised in prior stakeholder comments.

3. CPM Bids Above the Soft-Offer Cap

The current tariff allows generators to file for compensation above the soft offer cap using the current RMR pro forma which allows for total cost recovery (AFRR) and retention of market revenues.[12] As argued throughout the RMR and CPM enhancement stakeholder process and in response to CAISO's April RMR Tariff Filing, CAISO's existing tariff for CPM compensation above the soft offer cap is unjust and unreasonable.

Given that CAISO's tariff was not been amended in its April filing to FERC, the CPUC maintains that full sunk cost recovery (including return of and return on all undepreciated capital) as well as return of net market revenues is unjust and unreasonable because it ***guarantees*** resource owners ***more than*** just full sunk cost recovery. If cost-of-service is just and reasonable, then above cost-of-service is not. CAISO should modify its tariff to provide compensation based on a filing to FERC justinfying only GFFC (not including the 20 percent adder).

Additional Comments

Use of a 20 Percent Adder in Setting the Soft-Offer Cap Price

[10] CAISO, "Capacity Procurement Designation on 12/22/17," available at http://www.caiso.com/Documents/CapacityProcurementMechanismDesignation-122217.html#search=CPM%20Encina.

[11] CAISO, "December 22, 2018 Year Ahead Local CPM Designation Report," available at http://www.caiso.com/Documents/December222017YearAheadLocalCPMDesignationReport.pdf.

[12] CAISO Tariff, § 43A.4.1.1.1 "For a resource whose sales are under FERC jurisdiction that is providing CPM Capacity to be compensated at a rate higher than the CPM Soft Offer Cap, the resource owner must make a limited resource-specific filing before FERC to determine the just and reasonable capacity price for the resource as calculated per Schedule F to the pro forma RMR Agreement in Appendix G of the CAISO Tariff."

CAISO's current tariff provides CAISO the flexibility to consider the use of a 20 percent adder in updating its CPM soft offer cap no later then then every four years. The tariff specially states that the statekholder process may consider "what resource serves as the reference resource, the components of fixed costs that are considered in setting the CPM Soft Offer Cap, or **the use of a 20% adder** to costs to set the CPM Soft Offer Cap."[13] Staff request the CAISO add this issue to the scope of this initiative.

In its October 2015 Order, FERC found that GFFC plus a 20% adder "should allow sufficient recovery of fixed costs plus return on capital to facilitate incremental upgrades and improvements by resources." However, Staff believes that FERC may have misunderstood that CPM designated resources also have an opportunity to earn returns in the market (over and above their going-forward fixed costs and, thus, an opportunity to contribute to sunk cost recovery).

To allow generators to be awarded both a 20% adder and the retention of market rents makes little sense for purposes of mitigating market power and could potentially incentivize withholding in the bilateral market. For these reasons, Staff requests the removal of the 20 percent adder from the CPM soft-offer-cap calculation. GFFC plus retention of market rents provide "sufficient recovery of fixed costs plus return on capital to facilitate incremental upgrades and improvements by resources"[14]

The 2015 FERC Order approving the CPM soft offer cap states that:

> CAISO asserts that since the reference resource is based on the CEC's mid-cost case, CAISO claims that the 20 percent adder will allow for resources with costs higher than the mid-cost case to recover their fixed costs. CAISO also argues that the 20 percent adder establishes a CPM soft offer cap at the higher end of the range of resource adequacy prices, which will ensure that the CPM does not provide disincentives for load-serving entities to enter into bilateral resource adequacy contracts instead of relying on backstop CPM procurement. Finally, CAISO contends that the 20 percent adder will appropriately capture uncertain or difficult to quantify costs in addition to any margin of error in the CEC study.[15]

The order also notes CAISO belief that CPM soft-offer-cap will be sufficient to mitigate market power.

> CAISO states that its transition from administrative pricing to competitive pricing requires some form of market mitigation because there may be a limited pool of non-resource adequacy resources available to meet a given reliability need. Therefore, <u>CAISO explains that the potential exists for resources to exercise market power and asserts that the soft offer cap will both ameliorate these concerns and provide necessary market mitigation.</u>[16]

---

[13] CAISO Tariff 43A at 16
[14] 153 FERC ¶ 61,001 at 29
[15] 153 FERC ¶ 61,001 at 13
[16] 153 FERC ¶ 61,001 at 14

As documented above, the soft-offer-cap has several purposes:

1.) It provides a buffer for resources that have fixed costs above the mid-case to be able to recover their costs under the CPM mechanism,
2.) It is provides a disincentive for LSEs to rely on the mechanism to meet their capacity needs (since CPM prices would be higher than current bilateral prices), and
3.) It is providing market power mitigation.

Purposes 2 and 3 appear contradictory, since providing a disincentive for an LSE to rely on the mechanism also provides an incentive for a generator to use that mechanism.

Removal of the 20 percent adder will still allow for resources that have cost higher than the reference units GFFC (purpose 1) to file for cost recovery at FERC. Removing the 20 percent adder will still keep the soft offer cap higher then the current weighted average capacity costs reported in the bilateral market. Therefore, it would still provide a disintentive for LSEs to rely on the mechanism (purpose 2). Finally removal of the 20% adder will more adequately mitigate market power (purpose 3) and withholding in the bilateral market since it will move the soft-offer-cap closer to average bilateral capacity prices.

Allocation the Flexible Capacity for Annual CPM Designations

Under current CPM tariff provisions for system or local designations, CAISO does not obtain the flexible capacity attributes, nor does it allocate the flexible capacity to load serving entities to reduce their otherwise applicable capacity requirements. For example, for the Encina and Moss Landing CPM designations that occurred in 2018, CAISO did not obtain the flexible capacity, nor did it allocate it to load serving entities.

As a result, these resources were required only to bid or self-schedule during the availability assessment hours (e.g., 4 to 9 pm), meaning that the larger must-offer assessment hours did not apply and, if the resource self-scheduled, they would not need to bid into the real-time market. Not allocating flexible capacity effectivelystrands the flexible capacity, removes the more stringent bidding requirements and penalty provisions, and potentially allows resources to avoid any real-time bidding obligations, all of which jeopardizes reliability if CAISO does not have access to flexible resources to address ramping and other reliability needs on the system.

In addition, CAISO does not allocate the flexible capacity benefits for system and local CPM annual designations (and did not in the instance of Encina and Moss Landing), meaning that despite the fact that consumers were ultimately paying the going-forward fixed costs (plus a 20 percent adder), customers did not receive all of the benefits that these resources could potentially provide.

The CPUC believes that it is unjust and unreasonable to pay for capacity and not receive the corresponding benefits. The CAISO has recognized the benefits of allocating the flexible capacity associated with RMR agreements:

> [I]f the RMR resource has effective flexible capacity (EFC), it will have a flexible capacity MOO for the highest flexible capacity category for which the RMR capacity qualifies under the existing tariff. This change will update the RMR agreement to align it with the RA and CPM resources the CAISO relies on to serve demand and meet reliability needs through market optimization.[17]

Given that CAISO has filed tariff proposing to allocate the flexible capacity for RMR (for uneconomic resources), the CPUC sees no reason not to allocate the flexible capacity for CPM designations (for economic resources) needed to backstop the resource adequacy program and urges FERC to require CAISO to obtain the flexible MOO and allocate the corresponding capacity benefits.

Revise the cost allocation methodology for annual CPM designations to account for intra-year load migration

In its RMR CPM Stakeholder initiative, the CAISO decided that it was not necessary to address the current cost allocation mechanism, proposing instead "to keep the current year-ahead CPM local collective deficiency procurement cost allocation methodology, as it believes that the issue of load migration has largely been addressed by the CPUC's June 2018 RA Decision."[18]

Staff does not believe that the CPUC's 2018 RA decision (D.18-06-030) addresses all of the issues of load migration**.** For example, load migration can still occur from month to month even after the year ahead forecast is locked down. While the decision attempts to lock down some level of certainty around large amounts of load migration it does not completely eliminate the possibility of load migration occurring from month to month. Staff recommends that the CAISO use the same cost allocation mechanism used for monthly and intra-monthly CPM designations.

---

[17] ER-19-1641-000 CAISOs April 22nd RMR and CPM Tariff Filing, p. 76.
[18] RMR and CPM Enhancements September 19, 2018 Straw Proposal at p.4