



## Comments on the Issue Paper and Straw Proposal on Commitment Cost Enhancements

Department of Market Monitoring  
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The Department of Market Monitoring (DMM) appreciates this opportunity to comment on the ISO's issue paper and straw proposal on commitment cost enhancements. DMM is very supportive of the ISO's current proposal. DMM finds that the ISO proposal balances the ability of participants to bid in start-up and minimum load costs, capped at 125 percent of proxy costs,<sup>1</sup> with the ability to implement incremental changes to address some of the challenges identified this past winter.

### Background

The ISO faced two issues this past winter that resulted in inefficient commitment of resources, most notably on February 6. Both issues resulted in start-up and minimum load costs looking cheap relative to the incremental costs of energy. As a result, many resources were set to minimum load. The issues are:

1. **Lagged natural gas prices in the day-ahead market.** The day-ahead market run on February 5 for use on February 6 used the natural gas prices traded on February 4 for use on February 5. Natural gas index prices for use on February 5 were about \$8.00/MMBtu, whereas natural gas index prices were up to almost \$25/MMBtu at some locations for use on February 6. This created inefficient commitment of resources that elected the proxy cost option for start-up and minimum load costs as the gas prices given the significant increase in prices for gas used on February 5 compared to as used on February 6.
2. **Most units on registered not proxy cost option.** On February 5, most of the units had elected the registered cost option for start-up and minimum load costs. Even if the ISO was able to reflect the natural gas prices traded on February 5 for use February 6 in proxy costs used in the day-ahead

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<sup>1</sup> The 125 percent increase is not just limited to proxy costs associated with natural gas prices. The 125 percent level is inclusive of all proxy costs including major maintenance adders and greenhouse gas costs as well as a 10 percent adder in addition to fuel costs that are a part of the proxy cost itself. Thus, participants have the ability to cover more than just 125 percent of natural gas price variability.

market for use on February 6, the solution should not have improved appreciably because so many resources elected the registered cost option for their start-up and minimum load costs.<sup>2</sup> The gas prices used as part of the registered cost calculations were low relative to the high costs for gas used on February 6. The ability to switch from registered to proxy costs, while allowed, could not have been completed in time to address the change in gas prices on February 6. The ISO allowed the option for units to switch to the proxy cost option for the February 8 day-ahead market run.

### ISO proposal

The ISO proposes to use the manual approach for updating day-ahead natural gas prices approved in the temporary tariff waiver in March 2014.<sup>3</sup> This change addresses the first problem where units on the proxy cost option had costs reflective of prices for natural gas to usage the prior operating day. DMM supported this change during the tariff waiver process and continues to support this change as part of the ISO's proposal.

In order to address the second problem, the ISO proposes to eliminate the registered cost option altogether and increase the cap on minimum load and start-up costs from 100 percent of proxy costs to 125 percent of proxy costs. This allows participants to bid in minimum load and start-up costs up to a cap of 125 percent of proxy costs. DMM supports this change because it places an explicit cap on their ability to increase their start-up and minimum load costs, which will limit the potential for abuse of market power and it will allow for participants to bid in and manage natural gas price risk.

One of the reasons participants indicated the need for a 150 percent cap for the registered cost option was to address uncertainty related to natural gas price changes between the monthly natural gas futures price used in the registered cost option and the daily spot natural gas price. As the ISO noted in its proposal, in over 99 percent of days since the ISO nodal market began in April 2009, the daily variability of spot natural gas index prices was less than 120 percent and only 7 days had variability that exceeded 125 percent. Thus, DMM believes that allowing participants to bid up to 125 percent of proxy costs would allow participants to cover almost all costs.

Just two years ago, the ISO held a stakeholder process to further identify measurable and verifiable start-up and minimum load costs not incorporated in the proxy cost calculation.<sup>4</sup> This process led to the inclusion of major maintenance adders and the grid maintenance charge to proxy costs. This change was implemented as part of the ISO's fall release in 2013. As part of the stakeholder process in 2012, participants had the opportunity to identify and quantify legitimate costs that could be included in the proxy cost calculation. DMM believes that the proposed bidding cap of 125 percent of proxy costs will

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<sup>2</sup> See discussion in the following ISO technical paper:

[http://www.caiso.com/Documents/TechnicalBulletinGasEvents\\_MarketResults\\_Feb6\\_2014.pdf](http://www.caiso.com/Documents/TechnicalBulletinGasEvents_MarketResults_Feb6_2014.pdf).

<sup>3</sup> The ISO straw proposal can be found here: [http://www.caiso.com/Documents/2014-04-30\\_CommitmentCost\\_StrawProposal.pdf](http://www.caiso.com/Documents/2014-04-30_CommitmentCost_StrawProposal.pdf).

<sup>4</sup> See <http://www.caiso.com/informed/Pages/StakeholderProcesses/CommitmentCostsRefinement2012.aspx>.

allow participants to address most variability and that the ISO process of updating day-ahead gas prices in extreme events will act as a new layer of protection that did not exist previously.

DMM believes that the changes proposed by the ISO are targeted and incremental. These changes provide additional ability for participants to bid in their start-up and minimum load costs within a bounded framework. This will limit the ability of participants to exercise market power and will allow participants to better manage natural gas price risk.

### **Alternative approaches**

Some stakeholders have suggested that the cold weather experienced this past winter should be addressed by allowing participants to submit their own start-up and minimum load bids without any specific limits, and then only apply mitigation through some form of *ex post* review of costs. DMM strongly opposes this type of fundamental modification in the current process for limiting start-up and minimum load bids for a variety of reasons.

First, it is important to remember that in 2013 the ISO just completed a process to lower the limit on start-up and minimum load bids in order to limit potential gaming or manipulative practices aimed at profiting from high bid cost recovery payments. The ISO has adopted rules to address specific practices by one participant aimed at profiting from high minimum load bids under the registered cost option.<sup>5</sup> The lower 150 percent limit implemented in 2013 is seen as an important protective measure against other such practices.<sup>6</sup>

Second, DMM notes that if rules are modified to allow participants to submit their own start-up and minimum load bids without any specific limits, some form of mitigation will still be needed. Any *ex post* review of bids would be very administratively burdensome, and would not mitigate the distortion in the market that would have already occurred due to use of the unmitigated bids.

Another option that has been discussed in the past has been to automatically apply mitigation only when it is determined that a unit may have local market power – such as the ISO’s automated procedures for energy bid mitigation. In practice, however, units may have market power as a result of various capacity constraints that require units to be committed and operate at least at minimum load. These constraints include the minimum on-line constraints (MOCs) and new constraints being added through the flexible ramping product and the contingency modeling enhancements. Unlike

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<sup>5</sup> See the following filings for further information: California Independent System Operator Corporation, “Tariff Revision and Request for Expedited Treatment,” March 18, 2011: <http://www.caiso.com/2b45/2b45d10069e0.pdf> and “Tariff Revision and Request for Waiver of Sixty Day Notice Requirements,” June 22, 2011: [http://www.caiso.com/Documents/2011-06-22\\_Amendment\\_ModBCRules\\_EDEnergySettRules\\_ER11-3856-000.pdf](http://www.caiso.com/Documents/2011-06-22_Amendment_ModBCRules_EDEnergySettRules_ER11-3856-000.pdf). Also see “Order approving stipulation and consent agreement” in FERC Docket Nos. IN11-8-000 and IN13-5-000, July 30, 2013: <http://www.ferc.gov/CalendarFiles/20130730080931-IN11-8-000.pdf>.

<sup>6</sup> Part of the reason for this rule change was to protect against any new practices that might become profitable given changes that the ISO made to bid cost recovery rule in 2014. Under these new rules, bid cost recovery payments are now calculated separately for the day-ahead and real-time markets, rather than netting any net revenues from one market against any bid cost recovery shortfall in another market.

transmission constraints used to determine if energy bid mitigation should be triggered, these other constraints are much more complex and may not be binding when market power may occur.

**Conclusion**

DMM supports the ISO's proposal to reflect updated natural gas prices on days with extreme natural gas price volatility, to eliminate the registered cost option, and to allow resources to bid in start-up and minimum load costs up to 125 percent of proxy costs on a daily basis. We believe these changes are targeted and incremental in addressing the issues identified during the unusual and extreme weather events during this past winter.