

# Review of Reliability Must-Run and Capacity Procurement Mechanism Issue Paper & Straw Proposal

## Comments by Department of Market Monitoring March 7, 2018

DMM appreciates the opportunity to comment on the ISO's *Issue Paper & Straw Proposal - Review of Reliability Must-Run and Capacity Procurement Mechanism* published on January 23, 2018.

### Summary of Comments

The ISO's Review of Reliability Must-Run and Capacity Procurement Mechanism initiative ("Review of RMR & CPM") phase 1 proposes requiring that reliability must-run ("RMR") units have a must-offer obligation. DMM strongly supports a must-offer obligation for RMR units. In its November 2017 comments on FERC docket ER18-240, DMM stated:

To ensure mitigation of local market power and avoid artificial inflation of overall market prices, the limits on market participation by Condition 2 units must be removed and a must offer requirement must be established for all units under Condition 1 and Condition 2 of the CAISO's RMR tariff and contract provisions.<sup>1</sup>

Phase 2 of the Review of RMR and CPM initiative will focus on RMR refinements and instituting a cohesive RMR and CPM procurement framework. As discussed further below, DMM has several recommendations to address shortcomings in the current RMR and CPM process. The most important issue to address is fixed cost compensation in the *pro forma* RMR contract. RMR compensation currently allows RMR units a return on what the ISO calls the "full fixed cost of service" (i.e., sunk capital costs minus depreciation). The allowed rate of return also appears to be unduly high. As a result, RMR compensation is inflated above a just and reasonable level. If units continue receiving an unreasonably high rate of return on an inappropriately high cost basis, RMR applications may rise in 2018. The ISO can mitigate this adverse market impact by addressing capital cost compensation as soon as possible.

### Comments on Phase 1

The ISO proposes that for condition 2 RMR units the ISO will generate and submit bids using the "ISO-generated bid calculation methodology for that unit the same way the ISO currently does

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<sup>1</sup> *Motion to Intervene and Protest of the Department of Market Monitoring of the California Independent System Operator Corporation*, FERC Docket ER18-240, November 22, 2017, p. 16:  
[http://www.caiso.com/Documents/Nov22\\_2017\\_DMMMotion\\_Intervene\\_Protest-MetcalfEnergyCenterRMRAgreement\\_ER18-240.pdf](http://www.caiso.com/Documents/Nov22_2017_DMMMotion_Intervene_Protest-MetcalfEnergyCenterRMRAgreement_ER18-240.pdf).

for RA units that do not submit an energy or AS bid.”<sup>2</sup> Creating a must offer obligation and generating bids for condition 2 units that do not submit bids would be a major improvement to the ISO’s RMR policy. This should mitigate the potential for future RMR designations to significantly harm spot market efficiency by artificially inflating energy market prices.

## Comments on Phase 2

The second phase of the Review of CPM & RMR initiative has a longer timeline and larger scope. In several recent FERC and ISO proceedings DMM has commented on the shortcomings of the CPM and RMR processes. In DMM’s comments in the FERC proceedings on the Metcalf Energy Center RMR, DMM described several general issues with current CPM and RMR policy. DMM strongly encourages the ISO to address each of these issues in Phase 2 of the initiative:

- The timeline of the resource adequacy program and the Capacity Procurement Mechanism process should be moved back to accommodate the actual timeline needed to make decisions about resource retirements and potential alternatives for meeting local needs.<sup>3</sup>
- The CAISO’s first option for procuring additional capacity needed to meet reliability requirements – the capacity procurement mechanism – is voluntary and can be declined by suppliers with local market power.<sup>4</sup> This could undermine the capacity procurement mechanism if suppliers view RMR compensation to be more favorable than capacity procurement mechanism compensation.

Moreover, the ISO’s current RMR policy allows cost recovery of (and rate of return on) a resource’s stated sunk capital costs, minus depreciation. The ISO refers to this as “full fixed cost of service.” DMM believes that compensating a resource based on its full sunk capital costs (after depreciation) is unjust and unreasonable.

In the ISO’s Risk of Retirement Capacity Procurement Mechanism proceeding at FERC, the ISO argued that FERC precedent requires that RMR compensation must be based on this “full fixed cost of service” value. As stated by the ISO:

They [the protesters] also ignore Commission precedent that compensation for any mandatory backstop designation – which, under the CAISO’s proposal, would include

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<sup>2</sup> *Review of Reliability Must Run and Capacity Procurement Mechanism Issue Paper and Straw Proposal for Phase 1 Items*, January 23, 2018, p. 4: <http://www.caiso.com/Documents/IssuePaperandStrawProposal-ReviewReliabilityMustRunandCapacityProcurementMechanism.pdf>.

<sup>3</sup> DMM Motion under ER18-240, p. 8.

<sup>4</sup> DMM Motion under ER18-240, p. 8.

ROR CPM designations – must be based on a resource’s full fixed costs, not its going-forward fixed costs.<sup>5</sup>

This assertion is incorrect. FERC has not established the precedent that RMR compensation must be based on full fixed cost of service. FERC has ordered that some fixed cost recovery is reasonable, but has left room for RTO/ISOs to negotiate an appropriate RMR rate somewhere between going forward fixed costs and full fixed cost of service. In a 2015 NYISO RMR tariff filing FERC stated, “[c]ompensation to an RMR generator must at a minimum allow for the recovery of the generator’s going-forward costs, with parties having the flexibility to negotiate a cost-based rate up to the generator’s full cost of service.”<sup>6</sup>

DMM strongly recommends that the ISO not base its RMR (or other backstop procurement) compensation policy on the incorrect assertion that FERC is requiring ISOs to compensate RMR units based on the units’ full sunk capital costs (minus depreciation). The ISO should work with DMM and other stakeholders to establish the appropriate theory for determining the fixed cost compensation for RMR and other backstop procurement resources.

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<sup>5</sup> *Motion for Leave to Submit Answer to Protests and Comments of the California Independent System Operator*, FERC Docket ER18-641, February 2, 2018, p. 15:

<https://elibrary.ferc.gov/IDMWS/common/opennat.asp?fileID=14814948>.

<sup>6</sup> *Order Instituting Section 206 Proceeding and Directing Filing to Establish Reliability Must Run Tariff Provisions*, FERC Docket EL15-37, 150 FERC ¶ 61,116, February 19, 2015, p. 17: <https://www.ferc.gov/whats-new/comm-meet/2015/021915/E-8.pdf>.