

Stakeholder Comments

Energy Imbalance Market Year 1 Enhancements: Phase 2 Draft Final Proposal

**Department of Market Monitoring
October 30, 2015**

I. Summary

The Department of Market Monitoring (DMM) appreciates the opportunity to comment on the Energy Imbalance Market Year 1 Enhancements Phase 2 Draft Final Proposal. DMM supports the design changes to the Energy Imbalance Market (EIM) described in the EIM Year 1 Enhancements Phase 2 Draft Final Proposal. Specifically, DMM supports the ISO's proposed changes to EIM transfer limit congestion rent allocation, and DMM supports continuing to apply market power mitigation to EIM transfer limits in a way that is consistent with the treatment of internal transmission constraints. We provide further details and address some stakeholder concerns in comments below.

II. EIM transfer limit congestion treatment

DMM supports the ISO's proposed revisions to the allocation of congestion revenues from some types of EIM transfer constraints. These revisions would only apply to transfer constraints at interfaces which link two EIM balancing areas along with one or more non-EIM balancing areas. This type of interface is represented by a separate scheduling limit for each EIM balancing area.

Currently, real-time congestion revenues on this type of EIM transfer constraint are divided evenly among the connected EIM balancing areas. Under this design, an EIM balancing area that procures or builds an additional MW of transmission capacity that increases the scheduling limit for that EIM balancing area would only receive half of the congestion revenues from this additional transfer capacity. Since an EIM area would not receive all of the congestion revenues from the incremental transmission capacity it procures under this scenario, this may not provide incentives for procuring incremental transmission capacity to be used for EIM transfers over these interfaces.

Under Management's proposed year 1 phase 2 enhancements, each EIM balancing area will receive the congestion revenues associated with the scheduling limit for its own balancing area. DMM agrees that the ISO's proposed changes for allocating congestion revenues are more efficient and equitable than the current approach.

Some stakeholders expressed concern that allocating all congestion revenues associated with an EIM transfer constraint to the BAA in which the constraint is located would increase incentives for a BAA to withhold transfer capacity from EIM in an attempt to

maximize congestion revenues.¹ If such transmission withholding were to occur, it could then reduce incentives for third party generators to participate in EIM by depressing prices paid to generators for their incremental real-time production. DMM does not believe this concern warrants adjusting the ISO's proposal at this time.

Transmission rights between two EIM balancing areas that are not made available for EIM transfers should, under most conditions, still be used for base schedules that transfer power between the two EIM balancing areas. This would not generally constitute withholding of transmission capacity. Transmission capacity between two EIM balancing areas would only be potentially withheld if some portion of an EIM balancing area's scheduling rights to an EIM interface is not made available to support EIM transfers and is not ultimately used to schedule power between the two EIM balancing areas.

DMM believes the ISO's current proposal does not need to include measures to mitigate potential withholding of EIM transfer capacity for two main reasons. First, our current understanding is that in current and prospective EIM balancing areas, the parent company of the EIM entity will generally control most of the generation that would be dispatched up in real-time to support the real-time transfers that create the real-time congestion revenues. Therefore, increases in congestion revenues from withholding of EIM transfer capacity would likely be offset by decreased prices received by the parent company's generators. As a result, we do not currently anticipate conditions arising with the magnitude and predictability that would incent EIM entities to develop a strategy of withholding EIM transfer capacity.

Moreover, the determination of the actual allocation of congestion revenues to specific companies within each EIM balancing area remains the responsibility of each EIM entity.² The ISO's proposal only specifies the balancing area that should be allocated the EIM transfer congestion revenues. Depending on how the EIM entity's OATT specifies the actual final allocation of the congestion revenues received by the balancing area, the company that ultimately receives EIM transfer congestion revenues may not be the same company that makes the decision on whether or not to withhold EIM transfer capacity. Therefore, each EIM entity's determination of the final allocation of EIM transfer congestion revenues may effectively mitigate incentives to withhold transfer capacity without undermining the ISO's design principle of directing congestion revenues to the EIM balancing area that procured the congested transmission capacity.

In theory, scenarios could arise that may create incentives for an EIM entity to withhold EIM transfer capacity in order to impact prices in a balancing area and increase congestion revenues. If unused transmission capacity between two EIM areas is not being made available as EIM transfer capacity, and this withholding is contributing to

¹ See the comments on the Draft Final Proposal by Southern California Edison and Six Cities available at: <http://www.caiso.com/informed/Pages/StakeholderProcesses/EnergyImbalanceMarketYear1Enhancements.aspx>

² For example, allocation as determined by the OATT of the EIM entity to different parties within the BAA that may have funded transmission revenue requirements.

locational price differences that benefit the withholding entity, we would support the ISO considering future design measures to mitigate this potential exercise of market power.

However, under this scenario, we recommend that more thoughtful options are considered besides simply reverting to the EIM market design currently in production. The current approach of evenly splitting the EIM transfer congestion revenues between the two EIM areas that share an interface with a non-EIM balancing area may not be the most appropriate or effective method of mitigating the exercise of such market power. While allocating half of congestion revenues to companies in another EIM area would indeed reduce the incentives for an EIM entity to withhold transfer capacity, there may be more targeted mitigation methods that would be more effective and equitable.

Some stakeholders have expressed concern that the ISO's proposal may create structural issues which could result in market revenue shortfalls and/or undesired market incentives.³ In response to stakeholder comments, we worked with the ISO to review details on how the ISO plans to implement the proposal in settlements. Based on this review, the ISO's proposal for allocating congestion rents from EIM transfer constraints should not create market revenue shortfalls. Rather, the implementation should work as intended to allocate the congestion rents that accrue from the EIM transfer constraints.

Specifically, the ISO clarified that the allocation of real-time congestion rents for each constraint, including EIM transfer constraints, is derived in the same way that the real-time congestion rents are created in the market: From *changes* to base schedules in real-time. Therefore, there should not be concerns that the allocation method itself may create revenue imbalance. Instead, the allocation method should simply be allocating the exact congestion rents that are collected from the real-time changes to base schedules.

III. Market power mitigation for EIM transfer constraints

While finalizing the market power mitigation provisions in effect at the time the EIM was implemented in 2014, the ISO committed to looking at a more dynamic test for triggering market power mitigation for EIM transfer constraints. This dynamic trigger would have made an assessment on whether to deem an EIM transfer constraint into an EIM BAA competitive, using potentially very different logic than the three pivotal supplier test used for all other constraints. If the new dynamic trigger had deemed the transfer constraint competitive, then the transfer constraint would be excluded from the traditional market power mitigation process.

DMM supports the ISO's proposal to not add new market power logic that could exclude EIM transfer constraints from the traditional market power mitigation processes. The EIM transfer constraints create isolated, local areas within the larger system in much the same way as flow-based transmission constraints do. Therefore, when transfer

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constraints bind and elevate prices in EIM BAAs relative to the broader system, the constraints creating this price separation should be subjected to the market power mitigation processes like other constraints that create local price separation. It would be more appropriate to address any concerns over the fundamental logic of the three pivotal supplier test in a way that could adjust that logic for all constraints that create price separation between local areas.