



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 July 24, 2019. The straw proposal, 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 August 20, 2019.

Submitted by	Organization	Date Submitted
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Please provide your organization’s comments on the following issues and questions.

Prior to answering the specific questions posed by the CAISO in this template, IEP comments generally on the proposed changes to the Competitive Procurement Mechanism (CPM) most notably proposals to change the mitigation measures associated with the competitive solicitation process (CSP).

In the absence of a centralized capacity market, the CPM is the CAISO’s “backstop” capacity procurement mechanism employed primarily as a result of (a) deficient forward, bilateral procurement by LSEs (individually or collectively) and/or (b) insufficient setting of resource adequacy procurement requirements by LSE governing bodies. As a “backstop” capacity procurement mechanism, the CPM incents uncontracted supply to make itself available to the CAISO markets to help ensure grid reliability. Moreover, the CPM is designed to incent load-serving entities (LSEs) to procure needed capacity in the forward, bilateral markets to meet resource adequacy requirements. While performing this function, the CPM employs three discrete mitigation measures on suppliers, including (a)

a *Soft-Offer Cap* constraining bids in the CSP during periods of scarcity, (b) a *timeline* that forces supplier to bid resource capacity into the CSP in a manner that constrains their opportunity to “game” the bilateral contract market, and (c) a *cost-justification requirement* (based on FERC data) when bids exceed the Soft-Offer Cap.¹

By design, the CAISO CPM “backstop” procurement fits into a broader RA Framework characterized by three sequential phases which ostensibly work in a comprehensive manner.² In the RA Framework, procurement for needed capacity resources occurs sequentially generally as follows:

- **Phase I:** The CPUC sets RA procurement requirements for jurisdictional load-serving entities (LSEs) and monitors LSE performance.³ The CPUC may amend its requirements, including its overall RA Framework, consistent with PU Code Section 380. CPUC-jurisdictional LSE’s may procure bilaterally to meet their RA requirements.
- **Phase II:** The CAISO employs the market-based CPM/CSP to “backstop” shortages in LSE procurement. Uncontracted capacity bids/offers in the CSP are subject to a Soft-Offer Cap, currently \$6.31/kw-month. Supply offers up to that level are not subject to regulatory review.
- **Phase III:** The CAISO may procure needed resources at prices that exceed the Soft-Offer Cap in limited circumstances. Offers above the Soft-Offer Cap are required to demonstrate that the resource’s going-forward fixed costs (GFFC) plus 20% exceeds the soft-offer cap.⁴ Cost recovery above the CPM Soft-Offer Cap also is available to units entering into Reliability Must Run (RMR) contracts to mitigate the risk-of-retirement (ROR).

¹ *Capacity Procurement Mechanism Replacement: Draft final Settlement Document for ISO Board of Governors*, December 15, 2014, p. 7.

² The FERC has requested that the CAISO present changes to its capacity procurement mechanism (CPM) in a comprehensive manner. Indeed, the FERC rejected CAISO Tariff Amendments as recently as April 12, 2018 and encouraged the CAISO to propose a more comprehensive package of reforms consistent with specific guidelines. See Order Rejecting Tariff Revisions, Issue April 12, 2018, Docket No. ER18-641-000

³ PU Code Section 380 directs the California Public Utilities Commission (CPUC), in consultation with the CAISO, to establish resource adequacy requirements for all load-serving entities (LSEs) subject to CPUC jurisdiction (PU Code Section 380(a)). In addition, each load serving entity shall maintain physical generating capacity and electrical demand response adequate to meet its load requirements (PU Code Section 380(c)). To meet these policy obligations,

⁴ *Opinion on Reliability Must Run and Capacity Procurement Mechanism Enhancements*, Market Surveillance Committee of the California ISO, Draft of March 18, 2019, p. 9

The FERC has determined that changes to the CPM ought to avoid deleterious effects on the competitiveness of capacity procurement under the CPUC's resource adequacy program."⁵ Here, the CAISO is proposing to add yet another mitigation measure to the CPM. Specifically, the CAISO proposes to apply the 3-Pivotal Supplier Test to bids submitted in the CSP in the condition of 12-month CPM designations.

IEP is concerned that the CAISO proposal will have deleterious impacts on the current RA Framework in general and the CPM/CSP specifically. The CAISO proposal risks undermining the mechanism that incents uncontracted capacity to participate in the CAISO markets. The CAISO proposal also risks undermining the mechanisms by which the CAISO sends market signals regarding capacity scarcity. Accordingly, the CAISO proposal to modify the existing RA framework, absent a more comprehensive and wholistic review of the *entire* RA Framework is unjustified and unwarranted.

1. Maintain the CPM soft offer cap

Please provide your organization's feedback on this topic as described in section 5.1 of the [straw proposal](#). Please explain your rationale and include examples if applicable.

IEP supports the CAISO's proposal to retain the existing CPM Soft-Offer Cap currently set at \$6.31/kw-month. A reduced CPM Soft-Offer Cap is unlikely to reflect the cost of marginal capacity needed to maintain grid reliability, particularly in a period of scarcity which characterizes the resource adequacy market over the near- and medium-term. As noted above, changes to the CPM, particularly lowering the Soft Offer Cap, absent a comprehensive review of the RA Framework risks undermining the mechanism(s) that incent uncontracted capacity to participate in the CAISO markets. Lowering the Soft-Offer Cap also risks undermining the mechanisms by which the CAISO markets send signals to the market regarding capacity scarcity.

Please indicate any analysis and data review that your organization believes would be helpful to review on this topic. Please provide details and explain your rationale for the type of data and analysis that you suggest.

Prior to adjusting the CPM Soft-Offer Cap, the CAISO must conduct a thorough and comprehensive analysis to determine the true cost of marginal capacity used to meet

⁵ See Order Rejecting Tariff Revisions, Issue April 12, 2018, Docket No. ER18-641-000, Para 43, p. 16

resource adequacy requirements. As noted by the Market Surveillance Committee (MSC), setting the exact form of capacity demand curves can be contentious, but it is generally agreed that prices should fall somewhere between the incremental cost of the marginal (last) source of capacity and a multiple of net-cone as the RA market approaches scarcity or near scarcity levels.⁶

2. Changes to 12-month CPM designations

Please provide your organization’s feedback on this topic as described in 5.3 of the [straw proposal](#). Please explain your rationale and include examples if applicable.

IEP has strong concerns about the CAISO Straw Proposal to impose additional mitigation such as the 3-pivotal supplier test to uncontracted capacity voluntarily offering in the CPM. By design, most needed capacity is procured in the forward, bilateral markets; thereby, limiting the supply available to bid into the CSP. IEP anticipates that the CAISO proposal to subject voluntary bids in the CPM to a pivotal supplier test, particularly a 3-pivotal supplier test as proposed, will reduce the incentive for uncontracted supply to offer into the CSP given the high probability of being mitigated in CAISO markets characterized by capacity scarcity as is the situation today.

As noted by others, the 3-pivotal supplier test is inherently conservative. The FERC opined in 2012 that the CAISO’s market power screen, including the 3-Pivotal Supplier Test, “may be overly stringent” and “overly restrictive” for identification of market power in load pockets prior to accepting “backstop” CPM.⁷ The MSC, when examining the appropriateness of the 3-pivotal supplier test in CAISO markets, noted that “A key question to ask in evaluating a market-power mitigation mechanism is whether its effectiveness in enhancing competition produces efficiency benefits that exceed potential costs and burdens of additional regulation, including the efficiency losses of possible over-mitigation.”⁸ The MSC went on to state that “suppliers will only be able to pass a

⁶ *Opinion on Reliability Must Run and Capacity Procurement Mechanism Enhancements*, Market Surveillance Committee of the California ISO, Draft of March 18, 2019, p. 11.

⁷ Order Accepting Tariff Revisions, Issued March 1, 2012, Docket ER12-423-000, p. 12-13.

⁸ *Report on the Appropriateness of the Three Pivotal Supplier Test and Alternative Competitive Screens*, Members of the Market Surveillance Committee of the California ISO, Submitted to the Federal Energy Regulatory Commission, June 27, 2013, p. 13

three pivotal supplier test when there is an extremely large amount of surplus supply.”⁹ By design, the CPM “backstop” in the context of the RA Framework is not a market characterized by an extremely large amount of surplus supply.

Please indicate any analysis and data review that your organization believes would be helpful to review on this topic. Please provide details and explain your rationale for the type of data and analysis that you suggest.

The CPM currently has three mitigation measures, as noted above. Prior to imposing a fourth mitigation measure on supply bid in the CPM, the CAISO should study the effect(s) of imposing a 3-supplier test on supply bidding into the CPM during the 2018-2019 timeframe. How often would supply have been mitigated under each test, respectively, during this timeframe. What would be the overall efficiency benefits under each test? What are the incentives for forward contracting under each test?

In addition, the CAISO should analyze and compare the application of the 3-pivotal supplier test during the 2018-2019 timeframe to what would have occurred under a 2-pivotal supplier test; and, the CAISO should assess the costs and benefits of imposing the more stringent 3-pivotal supplier test compared to the 2-pivotal supplier test.

Additional comments

Please offer any other feedback your organization would like to provide on the [straw proposal](#) for the CPM Soft Offer Cap initiative.

In other markets, e.g. PJM, the goal of the 3-pivotal supplier test is to affect the *energy* markets and, thereby “lift mitigation in constrained markets where the market structure is reasonably competitive.”¹⁰ Here, in the context of the CPM, the goal appears to be to impose mitigation in the presence of *capacity* scarcity due primarily to deficient forward LSE procurement and/or inadequate setting of forward capacity requirements. The proposed CAISO “cure” is inappropriate for the disease.

⁹ Ibid, p. 16

¹⁰ *Three Pivotal Supplier Test: Theory and Application*, Presentation by Howard Haas, et al, PJM Market Monitoring Unit (MMU), August 20, 2007, slide 8

The CAISO Proposal risks replacing the existing 3-phased sequential RA Framework with essentially a 2-phased structure [forward bilateral procurement followed by RMR-like mitigation]. Rather than the engage in a piecemeal approach to RA reform and market power mitigation, the CAISO should undertake a comprehensive, wholistic review of the existing RA Framework. Following that review, the CAISO should propose reforms that are comprehensive and wholistic as urged by a number of parties over the years, including the FERC. At that time, if the CAISO determines that additional mitigation is needed in the CPM, the more appropriate pivotal supplier test to apply would be the 2-pivotal supplier test given the unique role that the CPM “backstop” procurement has in the 3-phased RA Framework.