



California ISO  
Shaping a Renewed Future

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*Addendum to the Draft Final Proposal*

# **Commitment Costs Refinements 2012**

**April 27, 2012**

# Commitment Costs Refinements 2012

*Prepared for discussion at a stakeholder conference call – May 2, 2012*

## 1 Introduction and background

The economic commitment of a generating resource in the ISO markets is based on its market energy and ancillary service bids as well as the cost of starting up the resource and its costs at its minimum operating level (pmin). That is, commitment costs – start-up (SU) and minimum load (ML) costs – are integral to the optimization’s choice to utilize the resource. Furthermore, commitment costs are part of the ISO’s bid cost recovery (BCR) calculation that determines whether or not a resource has a revenue shortfall over the course of a day. If, based on the BCR calculation, the resource does have a shortfall – meaning that its commitment and market bid costs are not covered by its market revenues – then the resource receives a BCR uplift payment. Thus, the accurate specification of a resource’s commitment costs is critical to efficient commitment and fair compensation of generating resources in our market.

Since the implementation of the ISO’s LMP market design on April 1, 2009, the ISO has made several market rule changes to increase the options and flexibility for market participants to specify start-up and minimum load costs. In the Commitment Costs Refinements 2012 initiative, the ISO and stakeholders have evaluated additional improvements to the specification of start-up and minimum load costs. Specifically, the ISO proposed costs associated with greenhouse gas emissions, the volumetric elements of the ISO’s grid management charge, and a fixed adder to cover major maintenance expenses be included in cost-based calculations.

In conjunction with incorporating these additional costs components into the ISO’s proxy cost calculations, the registered cost cap for minimum load and start-up costs was proposed to be reduced from 200 percent to 125 percent of the respective projected proxy cost, as calculated by the ISO for the resource every 30 days.

In this addendum to the draft final proposal for the commitment costs refinements initiative, the ISO proposes to modify the proposed level of the registered cost option cap from 125 percent of the projected proxy cost value to 150 percent of the projected proxy cost value.

## 2 Process and Timetable

The timeline for the brief stakeholder process associated with this addendum is included below:

April 27	Draft final proposal posted
May 2	Stakeholder conference call
May 7	Comments due *
May 16-17	Board of Governors meeting

\* Please e-mail comments to [comcosts2@caiso.com](mailto:comcosts2@caiso.com)

### **3 Change to the draft final proposal with respect to the cap for registered start-up and minimum load costs**

The current structure for generators to specify start-up and minimum load costs allows for two options: (1) the proxy cost option which is variable and tied to the natural gas price index and the heat-rate characteristics of the generating resource, and (2) the registered cost option which is a static value that is fixed for a minimum of 30 days after it is specified by the generator. Currently, the cap on the value that may be specified for the registered cost option for either start-up or minimum load is currently equal to 200 percent of the resource-specific projected proxy cost value as calculated by the ISO every 30 days.

The original motivation for providing the registered cost option was the recognition that there were potentially costs associated with starting up a resource and/or operating at minimum load that were not captured within the projected proxy cost calculation. Thus, the original intent of the registered cost option for start-up and minimum load costs was (1) to enable market participants to bid in higher start-up and minimum load costs for resources with non-fuel related costs not captured in the variable operations and maintenance (O&M) adder, and (2) to account for expected fuel price volatility. The current 200 percent cap on the static registered cost value was set so as to enable market participants to account for these cost elements while mitigating exposure to some – but not all – fuel price risk.

However, the ability to register minimum load costs up to 200 percent of actual costs served as a key mechanism in adverse market behavior that inflated bid cost recovery (BCR) uplift payments in the first half of 2011. This resulted in two emergency filings to revise the tariff's bid cost recovery provisions. Although these filings addressed the observed behavior, there may still be opportunities to exploit this 200 percent cap. This could involve: (1) resources bidding in such a way as to receive BCR in the DA market and then not delivering the DA schedule in real-time, or (2) deviating in real-time to avoid shutdown instructions. Both of these strategies could be profitable if a resource can earn minimum load costs that are in excess of its actual minimum load costs. Additionally, the ISO has recognized the ability and incentive to exploit these and other opportunities to increase bid cost recovery would be increased under the separation of the netting of day-ahead and real-time bid cost recovery calculations. As a result, the ISO is proposing bid cost recovery mitigation measures that are designed to mitigate the potential to increase bid cost recovery payments by not following ISO dispatch instructions and will also scale bid cost recovery payments to account for undelivered energy. Consequently, and also because we have proposed to explicitly incorporate additional costs into its calculated proxy costs for resources, the ISO has proposed as part of this initiative to lower this 200 percent cap.

The ISO proposes to keep the registered cost option to accommodate resources that have costs that are not incorporated into the proxy cost calculation. However, these additional costs should in the future be more limited as a result of this proposal. The additional cost components the ISO is also proposing to incorporate into its proxy cost calculations reduce the additional costs that are not explicitly accounted for and would need to be accounted for under the projected proxy cost multiplier. These additional costs – greenhouse gas costs, GMC costs, and major maintenance costs – are described in the draft final proposal and no changes are proposed to these elements of that proposal.

In this addendum to the draft final proposal, the ISO maintains the proposal to keep the registered cost option, but is now proposing a more measured approach to lowering the registered cost cap and is revising the proposal reduce the current 200 percent cap to 150 percent of the projected

proxy cost instead of lowering the registered cost cap to 125 percent of the projected proxy cost as previously proposed.

### ***Stakeholder and Market Surveillance Committee feedback***

Many stakeholders who provided feedback on the commitment costs refinements policy initiative had significant concerns about the proposed lowering of the cap for registered start-up and minimum load costs. Specific concerns included intra-day gas price volatility, the exposure of natural gas price risk for low-capacity factor resources, and natural gas balancing penalties (other than operational flow orders, which are addressed in the draft final proposal).

The ISO does not proposal to change the “safety valve” that allows a resource with registered costs (start-up or minimum load) to switch from registered costs to proxy costs if natural gas prices spike such that the calculated proxy value exceeds the resource’s registered costs.<sup>1</sup>

Stakeholders also contended that there are significant opportunity costs associated with starting up and running a resource if that resource is subject to contractual or environments constraints. This concern was strongly echoed by the Market Surveillance Committee in the March 30, 2012 meeting of that committee.

Stakeholders also raised some concern about the potential volatility and illiquidity of the GHG market upon its initial start-up in January of next year. The timing of the current anticipated implementation dates for all the other commitment costs proposal elements (that is, all but the GHG allowance cost adder) gives 9 months for the GHG market prices to settle before the registered cost cap is dropped.

Given these concerns, the ISO is revising the proposal for lowering the registered cost cap. The ISO believes that this will enable generators with costs not included in the new proxy cost calculation to have more flexibility to account for them through the registered cost option. Moreover, the new bid cost recovery mitigation measures being proposed by the ISO will mitigate current adverse incentives to increase bid cost recovery payments by not following ISO dispatch instructions.

### ***Addendum to the Draft Final Proposal***

In this addendum to the draft final proposal, the ISO maintains the proposal to keep the registered cost option, but revises the proposal to change the registered cost cap to 150 percent of the projected proxy cost. This change is made in light of the stakeholder and MSC feedback described above.

## **4 Conclusion**

The ISO will conduct a stakeholder conference call to review this addendum to the draft final proposal on May 2, 2012 from 10:00 to 11:00 a.m. The ISO appreciates stakeholder comments and discussion on this addendum. Please send your comments by close of business on May 7, 2012 to [comcosts2@caiso.com](mailto:comcosts2@caiso.com).

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<sup>1</sup> Please see CAISO Tariff section 30.4.1.2.