

Comments on Congestion Revenue Rights Enhancements Scoping Discussion

November 14, 2024 Working Group Meeting

Department of Market Monitoring

December 13, 2024

Summary

DMM appreciates the opportunity to comment on the *Congestion Revenue Rights Enhancements November 14th, 2024 Working Group Meeting*.¹ DMM continues to recommend that the ISO develop a CRR market design based on willing sellers, and that development of such an approach be a high priority in the current congestion revenue rights enhancements initiative.² In addition to addressing ratepayer losses resulting from the current CRR auction design, this willing seller market design would also address other stakeholder concerns raised in the scoping discussion, as explained in these comments.

Since the beginning of the ISO's nodal market in 2009, auction revenues collected from sales of CRRs have consistently been significantly lower than the payouts made for CRRs clearing the ISO's auction. The revenue loss from CRRs sold by the ISO in the auction is funded out of day-ahead congestion rents, which would otherwise be refunded to transmission ratepayers who pay the full cost of the transmission system.

In response to these systematic losses, the ISO instituted significant changes to the congestion revenue rights auction in 2019. While these changes reduced losses from the congestion revenue rights auction, the losses continue to be significant. From 2019 to 2023, losses from the auction have averaged about \$62 million per year, with CRR auction revenues equaling only 67 percent of congestion rents paid out to buyers of these CRRs.

Ironically, changes made in 2019 to reduce losses to transmission ratepayers by limiting CRRs clearing the allocation and auction have also reduced the ability of load serving entities to acquire CRRs needed to hedge their sources of supply. Similarly, the deficit offset charges – which have totaled about 25% of nominal CRR payouts to load serving entities – have further reduced the financial hedging value of CRRs acquired by load serving entities.

Since 2017, DMM has recommended that the ISO develop a CRR market design based on willing sellers that would not expose transmission ratepayers to these losses. Analysis of a willing seller design where the ISO acts as a central clearinghouse for trading, and does not intervene to sell contracts backed by transmission ratepayers, shows that the willing seller design is workable, and can provide an effective and efficient alternative to the current auction design.

¹ *Congestion Revenue Rights Enhancements Scoping Discussion, Working Group Meeting*, California ISO, November 14, 2024: <https://stakeholdercenter.caiso.com/InitiativeDocuments/Presentation-Congestion-Revenue-Rights-Enhancements-Nov-14-2024.pdf>

² *Willing seller market design for congestion revenue rights*, October 23, 2024. Department of Market Monitoring. <https://www.caiso.com/documents/willing-counterparty-whitepaper-oct-23-2024.pdf>

In addition to entirely eliminating ratepayer losses resulting from the current CRR auction design, the willing seller market design would also address numerous other stakeholder concerns that have been raised about the current allocation and auction process, as explained in the following section.

Other stakeholder concerns addressed by willing seller design

DMM understands that stakeholder concerns about the current allocation and auction, and the proposed willing seller design, include the following:

- Currently, some LSEs cannot obtain enough CRRs through the annual and monthly allocation process to hedge their expected supply contracts and resources.
- LSEs which utilize the monthly auction to purchase additional CRRs to fully hedge supply contracts and resources are concerned about how the willing seller design will impact to continue to acquire such CRRs in the monthly auction.
- The deficit offset charges implemented in 2019 to reduce losses from the auction— which have totaled about 25% of nominal CRR payouts to load serving entities – have also reduced the ability of load serving entities to utilize CRRs as hedges. Other entities have also seen a reduction in hedging ability due to deficit offset charges.

The willing seller design addresses all of these concerns as described below:

- Historically, allocated CRRs overall would be revenue adequate, and there would generally be significant congestion rent surpluses when valued at notional prices (i.e. before deficit offsets). For the four years from Q3-2020 to Q2-2024, DMM's initial estimates are that paying the full notional value of CRRs would have left a total revenue adequacy surplus equal to around 30% of the day-ahead congestion rents. Revenue inadequacy generally arises only after CRRs auctioned off by the ISO at a loss are subtracted from this congestion revenue surplus.
- The reduction in transmission model limits used in the CRR allocation and auction processes has been an attempt to address problems created by the auction, both in terms of revenue adequacy and transmission ratepayer losses. With the willing seller design, the transmission model in the allocation could be less restrictive and more allocated CRRs could be released.
- With the willing seller design, deficit offsets – which have totaled about 25% of nominal CRR payouts to load serving entities – would also be eliminated for allocated CRRs, without creating concerns about revenue adequacy or losses from auctioned CRRs.
- With the willing seller market design, deficit offsets for auctioned CRRs would be also be eliminated, since full funding of these CRRs would be guaranteed by the fact that all contracts have a counterparty. As a central clearinghouse, the ISO would enforce collateral requirements and controls but would not use congestion rents to fund auction CRRs.
- In an effort to limit losses from CRRs auctioned by the ISO, the ISO began restricting the source and sink pairs that can be traded in the auction in 2019. With these changes, participants are not allowed to submit bids for CRRs that sink at a generation node. For example, this prevents any entity from

directly selling a CRR to another entity wanting a CRR from a generation node to a DLAP.³ With the willing seller design, participants who are now barred from selling to entities wanting CRRs from a generation node to a DLAP/TH would no longer be barred from doing so. This would increase the kind of liquidity that we understand some LSEs, and generators, are concerned about.

- Results of the DMM paper on the willing seller design show that prior to the source-sink restrictions, there was ample selling by not only LSEs selling allocated CRRs, but also non-LSEs sales.⁴
- In the current monthly auction, an LSE's ability to clear more CRRs to a DLAP comes primarily from either (1) CRRs being sold back by other LSEs; or (2) bids from non-LSEs that are creating a counterflow between the source and sink nodes of the CRRs that LSEs are buying in auction. There are already participants willing to sell CRRs even within the current source-sink restrictions. With the willing seller design, not only would all of the same bids that are currently allowing LSEs to acquire more CRRs in the auction still be allowed, but with the current source-sink restrictions removed, participants would be allowed to sell CRRs directly to all entities wanting to buy CRRs sourced at generation nodes. Thus, the availability of such "counterflow" CRRs would be expected to still be available or even increase under the willing seller.

Thus, as described above, the willing seller would address other stakeholder concerns by:

- Allowing LSE to receive additional CRRs through the allocation process
- Maintain or increase the supply of additional CRRs offered in sold in the auction
- Ensure that all allocated and auctioned CRRs are fully funded without the need for any deficit offset charges

Data and analysis issues

CRR allocation model issues

DMM and the ISO have received examples and inquiries about specific CRR nominations that have failed to clear the allocation process, but which LSEs have subsequently been able to procure in the auction process. Transmission limits are meant to be kept constant in the allocation and auction, and participants are currently not allowed to submit bids to directly sell a CRR from a source to a sink. Therefore, these CRRs should only clear the auction as a result of: (a) CRRs allocated to LSE being resold in the auction, and/or (b) counterflows on the CRR path indirectly created by CRR purchased in the auction on other allowable source/sink combinations.

DMM believes that analysis of such examples using CRR model data would be very helpful in understanding and addressing limitations on CRRs clearing the current allocation process. DMM does not currently have access to the CRR model data needed to review such examples. However, DMM stands ready to work with the ISO to obtain and analyze CRR model data that may help better understand addressing limitations on CRRs clearing the current allocation process.

³ Only participants who already have a CRR sourcing at a generator node, either from the allocation or a previous auction, can sell CRRs that in effect sink at a generator node.

⁴ See *Willing seller market design for congestion revenue rights*, pp. 16-20.

Willing seller design issues

As described above, under the willing seller auction design, the transmission model in the CRR allocation could be less restrictive and more allocated CRRs could be released. The magnitude of these benefits could be assessed by re-running the CRR model with less restrictive transmission limits. By assessing different scenarios, the ISO could better understand the degree to which transmission limits could be relaxed in the allocation process without creating concerns about too much overall revenue inadequacy. DMM recommends that the ISO seek to perform such analysis as part of this initiative.