

Comments on Commitment Costs and Default Energy Bids Enhancements Revised Straw Proposal

Department of Market Monitoring

August 16, 2017

The Department of Market Monitoring (DMM) appreciates the opportunity to submit comments on the ISO's recent Stakeholder Working Group and Revised Straw Proposal on Commitment Cost and DEB Enhancements initiative.

Overview

In earlier comments dating back to 2016, DMM suggested that the ISO could split this initiative into multiple parts and implement elements that are easier to design first, while taking the additional time needed for elements such as designing dynamic mitigation system for commitment costs. DMM continues to believe this staged approach is necessary and appropriate.

These comments primarily address what DMM thinks the ISO should focus on implementing as the first phase of this initiative: (1) updating gas prices used in reference levels, (2) allowing participants to request adjustments to reference levels, and (3) validating those requests both before and after the market runs.

The development and implementation of dynamic mitigation of commitments costs is relatively complex and the ISO has made very limited progress on developing technical details of an approach for actually implementing this. Designing new mitigation protocols is a difficult process that needs to be carefully considered and tested. The proposed commitment cost mitigation design is very incomplete. We encourage the ISO to continue working on this as a second phase of this initiative.

DMM would not support increasing the current commitment cost bid caps above 125% under the proposed design for dynamic mitigation of commitment costs. We plan on carefully reviewing the commitment cost mitigation design that the ISO presented three business days ago and submitting separate comments with more details on problems with that design. We continue to recommend that the ISO separate this initiative into two steps so that the commitment cost mitigation can be more carefully designed.

Gas prices, adjustments, and review

ISO should make the use of updated next-day gas price index permanent

While the ISO seems to be making progress towards allowing the use of some updated gas prices in real time, it appears to be taking a step backward for the day-ahead market. Since implementation of Aliso Canyon phase 1 over one year ago, the ISO has been using an updated next-day gas index for default energy bids and proxy commitment costs used in the day-ahead market. In the current initiative, the ISO is inexplicably proposing to end this practice.

This simple enhancement has been implemented without any problems for over a year, and has eliminated the problems in the day-head market that had been caused by the one-day lag in gas prices

that previously existed.¹ The ISO has offered no reasonable explanation for why this simple and very effective enhancement would not be continued.

While it may still be possible for some participants to have their reference levels adjusted in time for the day-ahead market when the prices change significantly, it seems inefficient to not use the most updated gas price as a default. This updating should significantly decrease (or essentially eliminate) the need for fuel price adjustment requests in the day-ahead time frame.²

Reference level adjustments and reasonableness thresholds

DMM appreciates the ISO providing more details on the reference level adjustment process. However, the proposal may not allow reference levels to accurately reflect gas market conditions that change after the lagged next-day gas index is published. Therefore, DMM recommends that policy allow for DMM to have the discretion to recommend increases in reference levels and reasonableness thresholds using updated estimates of current market conditions.

DMM believes it will need to play a leading role in the processes for developing and approving reference level adjustments and calculating reasonableness thresholds. All market monitors for the other FERC jurisdictional ISOs serve this function of exercising their discretion in determining reference levels. DMM has extensive experience and skills to effectively fulfill this role – and there is no other ISO business unit that currently has the skills and experience.

Over the last five years, DMM has developed expertise and experience in dealing with gas prices, negotiated DEBs, MMAs, and other market features involving cost verification. DMM has performed extensive analysis of gas market data and has developed robust monitoring and metrics of daily gas spot market trends and information. Over the last 18 months, the ISO has relied primarily on analysis and recommendations of DMM to set and adjust special gas cost adders allowed to help manage potential issues caused by Aliso Canyon gas storage limitations.

DMM's earlier proposals for updating gas prices based on same-day trading information could be incorporated easily into a definition of a reasonableness threshold that would incorporate updated gas market information when appropriate. DMM can supplement the ICE gas market data it routinely monitors and analyses with any additional gas market data provided by participants as envisioned under the ISO's proposal.

The ISO's proposal for calculating reasonableness thresholds appears to create a quarterly threshold using historical data. The ISO seems to be concerned that using same-day gas information to evaluate fuel price adjustment requests will be construed as creating an index. However, same-day gas information will very often be the most relevant source of data to determine when market prices are moving away from the next-day index prices. Allowing DMM and/or other ISO staff the discretion to consider same-day gas market conditions in reference level adjustments or reasonableness thresholds would lead to more efficient market outcomes during unexpected gas market situations.

¹ See pp 92-93 in DMM's 2016 Annual Report:

<http://www.caiso.com/Documents/2016AnnualReportonMarketIssuesandPerformance.pdf>

And pp 68-79 in DMM's Q1 2017 report:

<http://www.caiso.com/Documents/2017FirstQuarterReport-MarketIssuesandPerformance.pdf>

² See results of analysis in document cited in footnote 1.

Ex-post review and acceptable evidence of gas prices

The ISO has proposed that when a fuel adjustment request does not pass the *ex-ante* screens, the request goes to an *ex-post* review with the potential to support an uplift payment to the resource. DMM believes that this basic design is appropriate, but again cautions that the details laid out in the ISO's straw proposal may make the process restrictive.

The ISO cites a requirement of 5 to 10 bids from different, nonaffiliated parties to establish gas prices for *ex-post* review. DMM agrees it is beneficial to have general rules governing what is considered liquid, and DMM has developed some such rules with ICE gas market data. However, in cases where such data do not exist, additional judgement will inevitably be needed. Guidelines should not be overly prescriptive so as to prevent the market from responding to known conditions on days that fall outside of the norm.

DMM believes processes and criteria for evaluation of gas price adjustments that fail the *ex-ante* screen may need to rely on judgment to some extent. That judgment should be informed by the best data available. Additionally, it may be difficult for the ISO or DMM to establish which gas market participants are affiliated. We propose the following three categories of evidence should be acceptable, and should be used along with the market monitor's discretion and judgement:

- Direct bilateral quotes from multiple entities;
- Comparisons of similar information provided by other participants; and
- Available market data (ICE, etc.)

DMM and/or other ISO staff will need to be able to use all of the above information to evaluate requests for adjustments that will be paid through bid cost recovery or any other special uplift payments.

DMM supports the ISO's proposal for disallowing for some period fuel adjustment requests from entities who repeatedly ask for adjustments and fail the *ex-post* screening. This should reduce incentives for generators to submit inappropriate requests.

Commitment cost bids and mitigation

DMM is still in the process of reviewing the ISO's latest changes to its proposal for Commitment Cost mitigation. We plan to submit further comments on this subject in the near future, but offer the following points at this time.

The ISO's proposal has seen notable development, but it is still incomplete. Several aspects of the proposal are either flawed or need more details and development before the ISO considers raising the current 125% cap on commitment cost bids. Issues that should be addressed include the following:

- In its latest stakeholder call on the matter, the ISO proposed to calculate a 'default shadow price' for use in determining when to mitigate commitment costs. DMM is not sure what theoretical idea is behind this idea or this calculation, and would like to understand from the ISO what this measurement is meant to represent. We also note several technical issues that would need to be resolved, including how to handle a time when the highest shadow price on a constraint coincides with a \$0 or negative SMEC.

- In the August 11 proposal to modify the RSI for non-binding constraints, the ISO has introduced a term in the denominator of the RSI that DMM does not understand and that seems to suggest that additional available supply should be counted as demand.³
- While the ISO has acknowledged MOCs as a non-transmission related constraint that can grant market power, it has not discussed any other such constraints. These constraints can include individual unit constraints, blocked shutdown instructions, CME constraints, and intertemporal issues. In particular, DMM and the ISO have previously identified intertemporal, unit-specific constraints that can be exploited in order to increase a generator's bid cost recovery. The current 125% cap on commitment cost bids mitigates these known unit-specific commitment and MSG transition BCR issues. Raising the caps without adequately addressing these issues could expose the ISO to substantial risk of inflated BCR.

Given the flaws and lack of detail in the ISO's commitment cost mitigation design, DMM would not be able to support a proposal to raise the caps on market-based commitment cost bids above the current level of 125%. Authority to raise these caps above the current 125% should be contingent on the details of the commitment cost mitigation design being fully worked out and the effectiveness of the mitigation being tested.

DMM also recommends a phased approach for raising the cap on market-based commitment cost bids once dynamic mitigation of commitment cost bids is implemented. For example, the caps could be raised from 125 percent to 150 percent initially, and then gradually raised as the ISO and DMM verify that the mitigation is effective and any enhancements that may be needed are implemented.

³ RSI calculation on slide 15:

http://www.caiso.com/Documents/Agenda_Presentation_CommitmentCosts_DefaultEnergyBidEnhancements_Aug112017.pdf