Stakeholder Comments Template

Subject: Cost Allocation to Convergence Bids

The CAISO is requesting written comments on the Straw Proposal for Convergence Bidding Cost Allocation that was discussed at the February 8th MSC/Stakeholder meeting. This template is offered as a guide for entities to submit comments; however participants are encouraged to submit comments in any format.

All documents related to cost allocation for Convergence Bids are posted on the CAISO Website at the following link:

http://www.caiso.com/1807/1807996f7020.html

Upon completion of this template please submit (in MS Word) to convergencebidding@caiso.com. Submissions are requested by close of business on Friday February 29, 2008.

Please submit your comments to the following questions for each topic in the spaces indicated.

CPUC staff appreciate the opportunity to provide comments in response to CAISO’s January 29, 2008 Straw Proposal for Convergence Bidding Cost Allocation. These comments address CAISO’s straw proposal and issues raised at the February 8, 2008 MSC meeting.

Under CAISO’s Market Redesign and Technology Upgrade (MRTU), FERC ordered CAISO to implement virtual (or convergence) bidding within one year of the launch of MRTU. Virtual Bidding is a market activity in which bids for energy supply or demand are made in the Day Ahead market with equal and opposite positions taken in the Real Time market (such that no energy is generated for actual consumption or delivery in Real Time). Virtual Bidding increases additional costs known as uplift costs. The clearing of Day Ahead and Real Time markets under MRTU will result in uplift costs being charged to market participants, and passed through to ratepayers. When energy bids clear in the Day Ahead and Real Time markets, costs associated with procuring ancillary services and other resources are later charged to market participants as uplift costs. Virtual bidding implementation, by increasing the volume of supply and demand bids, will add additional uplift costs to the markets.

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1. The proposed refinements to the cost allocation proposal described in the 2/9 Straw Proposal:

a) Allocates costs for IFM tier 1 and RUC Tier 1 based on each SC’s gross cleared virtual bids rather than the net of each SC’s virtual transactions, and

b) Allocates IFM Tier 1 Uplift to virtual demand only in the case where physical demand plus virtual demand exceeds the CAISO Forecast.

c) Allocates RUC Tier 1 Uplift to virtual supply based on the quantity of physical supply that was displaced by virtual supply in the DAM resulting in the need for the CAISO to procure additional supply in RUC. This quantity is equal to the net of all cleared virtual demand and all cleared virtual supply if the net virtual supply is positive.

Is this proposal a reasonable assessment of the uplift costs that should be imposed upon virtual transactions? How might it be improved?

CAISO proposes allocating a pro-rata share\(^2\) of Integrated Forward Market Tier 1 uplift costs to virtual demand bidders (when virtual demand + physical demand > CAISO forecast) and allocating a pro-rata share of Residual Unit Commitment Tier 1 uplift costs to virtual supply bidders (when virtual supply cleared in the integrated forward market > total virtual demand cleared in the integrated forward market). CPUC staff generally support this method of recovering Day Ahead uplift costs. However CAISO’s proposed cost allocation method should have a parallel cost allocation methodology for Real Time uplift charges resulting from virtual bids.

2. Is a flat fee a workable alternative for cost allocation to convergence bids as an initial starting point until the CAISO has market data available to analyze the impact convergence bids have on uplift costs?

CPUC staff may be willing to support an interim flat fee approach in lieu of a more refined cost allocation approach for the Real Time uplift cost allocation given CAISO’s stated concern over the complexity of allocating Real Time costs due to virtual bidding. However without a concrete proposal CPUC staff cannot adequately address this issue. For example, CPUC staff’s position might differ depending on whether the fee is an entry fee (i.e., a single fee covering unlimited bidding), a per bid fee, or other fee structure.

3. Other suggestions for methodology by which to allocate bid cost recovery uplift costs to convergence bids?

\(^2\) For details CAISO Straw Proposal examples 1 through 4.
CAISO Comments Template for Cost Allocation to Convergence Bids

CAISO should explore a second best option for real time cost allocation of virtual bidding until a more accurate cost allocation methodology is developed

CPUC staff recognize CAISO’s difficulty in allocating Real Time uplift costs to virtual bidders given, 1) that Real Time uplift charges may discourage virtual bidders from participating in the CAISO markets and, 2) the complexity of separating Real Time virtual bidding costs from other uplift costs. However, by not allocating Real Time uplift charges to virtual participants the CAISO will create a perverse cross-subsidy mechanism to virtual participants who will avoid Real Time uplift costs.

CAISO suggests that it will consider “a two-tiered design for Real Time bid cost recovery costs” later via a stakeholder process. CPUC staff recommend that CAISO explore a second best method whereby some “X” percent of the Real Time costs is allocated to virtual bidders. While the CPUC staff are not in a position at this time to determine what that “X” percent should be, CPUC staff maintain that CAISO should not deviate from the principle that Real Time uplift costs be allocated to virtual bidders based on some pro-rata share of virtual bidders’ contribution to Real Time uplift costs.

Conclusion

No provision of Real-Time uplift cost allocation to virtual transactions may cross-subsidize virtual market participants at the expense of physical load ratepayers

CPUC staff support CAISO’s Straw Proposal on the allocation of Day-Ahead market uplift costs to virtual bidders. However, by allocating Real Time market uplift costs entirely to the physical market participants CAISO undermines the cost-causation principle unduly exposing ratepayers to the costs of virtual bidding. Theoretically, virtual bidding can lower costs to ratepayers in the long run but, to date, no concrete data has been presented supporting such a result. Given this uncertainty, any CAISO proposal should seek to balance the need to protect California ratepayers from undue market forces against the goal of implementing market enhancements.