EPIC Merchant Energy
Comments to CAISO on Convergence Bidding and Bid Cost Recovery

EPIC Merchant Energy appreciates the opportunity to provide comments on the documents discussed at the CAISO’s October 16, 2008 Convergence Bidding stakeholder meeting.

Background

The discussion of uplift costs during the October 16 Convergence Bidding Meeting (“The Meeting”) was focused primarily on the calculation and allocation of these costs. There was very limited discussion about the actual cause of these charges and even those comments were based on correlation and not causation of uplift costs. At no time did any stakeholder at the Meeting provide any evidence that would establish that virtual transactions actually cause uplift costs.

EPIC believes that this discussion was premature. Treating the calculation and allocation of uplift costs to convergence bidders as a foregone conclusion neglects a vital stage in the design of the CAISO market: the establishment of cost causality. A well designed market is based upon a rational set of rules that are known to all participants. The future CAISO market should be no exception to this tenet. In this paper, EPIC discusses the reasons why we believe uplift costs should not be allocated to convergence bidders.

Expert Opinion

Currently, the Midwest ISO’s is in the process of revising the way the market determines the allocation of uplift costs. The current consensus of opinion among industry experts participating in this process is that virtual bids and offers do not cause uplift costs to be increased and therefore should be excluded from their allocation. A number of these experts have filed FERC testimony to this effect. For example:

1. The foremost authority on energy markets is Dr. William Hogan of Harvard University. Dr. Hogan recently published a paper papers on cost causation and cost allocation that is vital to the matter at hand. Dr. Hogan finds that allocating uplift charges to virtual transactions will “hinder the development of a competitive and efficient energy market.” Dr. Hogan’s paper can be found at: http://ksghome.harvard.edu/~whogan/.
2. Dr. Jonathan Lesser of Bates White also provided testimony in an EPIC filing to FERC on cost causation. In his testimony, Dr. Lesser makes it clear that he does not believe that virtual participants should be assessed uplift charges in the absence of cost causation.
3. Edison Mission also filed comments to FERC in this Docket. EPIC urges CAISO stakeholders to read this entire filing, including the testimony from Edison’s expert witnesses. For the sake of expedience, EPIC will provide some highlights:

1 Market-Clearing Electricity Prices and Energy Uplift (December 31, 2007)
Resource Sufficiency Guarantees, Cost Causation and Cost Allocation (October 9, 2008)
2 Reply Brief of EPIC Merchant Energy, Docket No. EL07-86-000, (October 9, 2008)
3 Answer of the Edison Mission Group Companies to Complainants’ Briefs, Docket EL07-86-000 (October 10, 2008)
a. The Edison filing quotes Dr. Hogan’s papers on cost causation and elaborates on why causation must be provided.
b. The Edison filing discusses a number of issues still outstanding in the CAISO dealing with Convergence Bidding.
c. Edison’s filing discusses at length the fact that cleared virtual bids do not cause uplift costs to be increased and why MISO’s RSG (uplift) costs should not be allocated to virtuals. The very same principles would apply to the CAISO market.

Cost Causality

Demonstrating cost causation is an absolute necessity in order to meet the burden of proof as described in the Federal Power Act. Causation must be shown in a meaningful way for all market-related charges so that all charges can be allocated in a rational manner. This is true for both the rate and the degree of the rate charged. Statements made at the Meeting by CAISO staff indicated that a cost causation study would not be feasible at this time. It was made clear that the CAISO feels that it must have post-MRTU market data before it can reasonably complete a cost causation study for convergence bidding. If this is the case, the ISO should not allocate any uplift costs to virtuals until such analysis is available. When the proper market data is analyzed and a study completed, then and only then, can it be determined what costs, if any, should be allocated to convergence bidders. The results of any such study must provide a direct causal link between virtual causal and uplift costs. Until such time, uplift costs should be seen by the market as a cost to serve load in order to ensure reliability and allocated as such.

The following excerpt from the Edison Mission FERC filing summarizes this position:

“EME witness Klein further explains why it is appropriate that RSG costs be allocated to load: RSG costs are incurred solely for the purpose of meeting load reliably and at least costs. Therefore, load is the beneficiary of RSG payments. Generating units that require make-whole payments are by definition units that are at or near the marginal cost of meeting load.......It is only proper that load pays for the generating cost of serving load. Indeed, the total cost that load pays for energy plus uplift (side payment to marginal generators) is assuredly lower than if load paid for no uplift and the energy prices were sufficiently high to compensate all marginal generating resources.”

Market Participant Differentiation

Financial market participants are fundamentally and necessarily different than market participants who serve load. Even if EPIC were to accept, and we do not, that financial participants were one cause of uplift costs, it does not follow that EPIC’s share of these charges should be the same as all market participants. The largest share of uplift costs stems from uncertainty in the real-time market. This uncertainty is primarily due to some combination of load forecast error, generation trips and reliability concerns. All virtual activity is known at the end of the Day Ahead market and therefore does not contribute to any Real Time deviations. It is necessary for the CAISO to treat these two very different types of market participants (physical and financial) differently.
The following excerpt from the Edison Mission FERC filing summarizes this position:

“RSG costs are incurred to ensure that sufficient, and the right mix of, generating units are committed in advance to ensure a reliable supply of energy to serve physical load in real-time. As EME witness Hartshorn explains, RSG costs are incurred when dispatchers use their discretion to manually commit and dispatch resources in order to respond to unexpected occurrences and ensure system reliability in real-time. These types of decisions would be made regardless of virtual supply activity in the day-ahead market, and the RSG uplifts associated with these decisions have no cost causation relationship with virtual supply offers. RSG is simply a form of reliability uplift that benefits physical load.”

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