EPIC Merchant Energy Comments on Convergence Bidding Credit and Collateral Requirements

EPIC appreciates the opportunity to comment on the development of credit and collateral requirements for Convergence Bidding (CB). Establishing appropriate credit requirements is an important step in assuring the success of the convergence bidding market and the MRTU. Recommending specific convergence bidding credit policies is made difficult since the overall design of convergence bidding remains under development. Nevertheless, EPIC recommends the following guidelines and principles that should be adopted by the CAISO as credit and collateral procedures, which are based on EPIC’s experience in the four existing CB (Virtual) markets.

FERC has directed that convergence bidding commence within one year of the implementation of the MRTU. There is an opportunity for CAISO to adopt appropriate and reasonable credit requirements, which properly match the risk that underlies the convergence bidding market. Of course, the credit requirements must be consistent with the conceptual design of CB. Therefore, it is imperative that the design elements for CB are made clear as soon as possible. The CAISO must provide a detailed CB design in order to facilitate work on those items related to CB, such as credit and collateral.

CAISO has proposed a set of credit requirements similar to those established by the New York Independent System Operator (NYISO) and the Midwest Independent System Operator (Midwest ISO). Some aspects of the eastern systems are beneficial to the market and some are not. The CAISO should be aware of past FERC Orders that have had an impact on credit initiatives submitted by other ISOs.

The CB (Virtual) market is recognized as a valuable component of successful LMP markets. PJM, NYISO, ISONE and the Midwest ISO have each established virtual bidding markets and these markets continue to be supported by those ISOs and their Market Monitors and FERC. The CAISO should not place obstacles such as onerous or unreasonable credit and collateral requirements on the CB market, which would discourage market participation and unduly discriminate. Other barriers to entry that may impede participation in the CAISO’s CB market include high bid charges, unfair allocation of uplift charges, delayed calculation of credit exposure, not calculating the appropriate credit exposure, or applying charges not associated with cost causation principles.

The CAISO should encourage and promote market participation in the CB market, including participation by small financial marketers. To ensure a robust CB market, one that provides all the benefits that have been identified and confirmed by the eastern ISOs, CAISO’s credit and collateral policies should be as reasonable and appropriate as possible. Encouraging market participation, which should increase the number of bids, would provide benefits for the market as a whole, including:

- Liquidity
- Price convergence
- Market power mitigation
To establish sound credit requirements the CAISO should implement a flexible value-at-risk system. The following list provides credit and collateral methodologies and system functionality the CAISO should adopt:

- Systems should be dynamic and real-time.
- The ability for Market Participants to move collateral quickly from one CAISO market to another (from CB to CRRs for instance).
- Credit calculations should be relatively easy to calculate.
- Requirements should match the underlying real risk of the CB market.
- Set credit limits not MW limits.
- Adjust collateral requirements for seasonality.
- NYISO, PJM, and MISO use 2-day multipliers for calculating credit exposure. If a MP’s exposure is calculated on a real-time basis no multiplier is needed.
- Before accepting bids, evaluate each bid to determine if the bids are in violation of e.g. MW limits or sufficient credit support. If limits are violated do not reject all bids, reject only the bids in violation. Use a last-in / first-out process.
- Consider two decrement bids at the same location for the same hour. One is bid at $1, the other at $100. The bid at $100 clearly present more risk. Its credit requirement should therefore be higher. This example illustrates that the credit requirement calculation should take into account the bid/offer price as well as a real-time expected value for the bid point.
  - To calculate the credit requirement using the bid/offer price and the expected value:
    - Credit Requirement for a DEC bid = Bid Price minus the RT Expected Value
    - Credit Requirement for an INC offer = RT Expected Value minus the Offer Price
    - Use historical RT prices to set expected values. For example, for 2008 use: 0.2 x 2005 + 0.3 x 2006 + 0.5 x 2007

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