

J.P. Morgan Comments

CAISO Issue Paper & Straw Proposal - Impact of Convergence Bidding Real-Time Imbalance Energy Offset

Submitted by	Company	Date Submitted
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J.P. Morgan Ventures Energy Corporation and BE CA LLC (together, “J.P. Morgan”) appreciates the opportunity to submit these comments on the California ISO’s (“CAISO’s”) Real-time Imbalance Energy Offset proposal.

Background

On April 27, 2011, the CAISO issued a paper entitled “Impact of Convergence Bidding on Real-Time Imbalance Energy Offset.” As previously explained by the CAISO, the real-time imbalance energy offset is a neutrality adjustment - either a charge or a payment to demand - based on whether the CAISO has sufficient revenue from real-time demand market charges to compensate supply procured in the real-time market, which includes the hour ahead scheduling process (HASP). If revenues are insufficient, the CAISO must charge demand. If revenues exceed the amount needed to pay supply, the excess is returned to demand. The CAISO states that since HASP prices are generally and consistently lower than real-time dispatch (RTD) prices, that this price difference encourages arbitrage between intertie supply and internal demand. The CAISO proposes a new settlement rule that reverses HASP to RTD revenues for the balanced portion of a Scheduling Coordinator’s portfolio.

Comments

Absent further analysis and a clear roadmap for addressing the more systematic issues driving HASP-RT price differences, J.P. Morgan does not support the CAISO’s settlement rule. J.P. Morgan believes that such a rule may inhibit market participants from establishing appropriate and necessary hedges within and outside the CAISO market and may have the unintended consequence of reducing both virtual bidding and physical imports/exports to/from the CAISO. Furthermore, Scheduling Coordinators, such as J.P. Morgan, may schedule for more than one market participant and it would be inappropriate to conflate the positions of these different entities when applying the proposed settlement rule.

J.P. Morgan is concerned that the CAISO is moving too quickly to implement a new settlement rule; a rule that is focused on the activity of a subset of market participants (virtual bidders) and

that does not address the primary issues driving price divergence between the HASP and RT markets. As acknowledged by the CAISO, real-time imbalance offset charges have decreased (trended down) in recent weeks, thus market conditions and related market activity, i.e., response by market participants to price differences, could be obviating the need for any market rule change. The CAISO should continue to monitor the market and the level of real-time imbalance energy offset charges and only implement interim measures when absolutely necessary.

As noted by the CAISO, the CAISO has taken steps to improve its load forecasting and operator biasing procedures and that such measures may reduce HASP-RT price divergence. In addition, the CAISO is proposing to shortly implement other measures, such as the new flexible ramping constraint, which may also reduce HASP-RT price differences. In light of these efforts the CAISO should conduct further analysis prior to implementing other interim and potentially unnecessary measures such as the proposed settlement rule.

J.P. Morgan observes that HASP and RT prices have diverged since the start of the CAISO's new market. Beginning in the middle of 2009 the CAISO observed increases in the real-time imbalance energy offset charge and began to explore the root cause driving the increase. The CAISO's analysis of the imbalance energy offset charges revealed that the increases were largely driven by the disparity between the prices produced in the HASP and the prices produced in real-time market. At that time in 2009, the CAISO stated that it would "continue to investigate and explore market design changes, including possible changes to the allocation rate design." In addition, the CAISO stated that its "analysis also reveals that the use of an average hourly price for real time demand imbalance energy settlement has an impact on the real-time imbalance energy offset. The simple averaging used to derive the hourly price for settlement purposes results in load being charged less when deviating upward than it would be charged based on an interval by interval basis, and being paid more when deviating downward." However, the CAISO concluded that, "At this time, the ISO does not propose a change in the design of the real-time hourly price at this time but continues to consider redesign of the real-time hourly price as part of the longer-term solution." In September 2009, the CAISO proposed to exempt MSS load-following entities from the real-time imbalance energy offset charges, stating that based on the rules and manner by which they operate such entities should not be subject to these charges. The CAISO stated that, "The ISO continues discussions with stakeholders to discuss longer-term solutions to address any concerns over the factors that contribute to the real-time imbalance energy neutrality offset."

Rather than focus on implementing another interim and incomplete solution J.P. Morgan recommends that, in addition to the measures noted above (e.g., improved load forecasting and operator biasing procedures) the CAISO devote its energy to implementing the long-term solutions first identified as needed almost two years ago. Moreover, the proposed settlement rule inappropriately focuses on the activity of virtual bidders and importers/exporters. Rather than inhibiting the activities of these market participants – activities that further price convergence in the CAISO's markets and provide valuable services in addressing over-generation and other operating conditions – the CAISO should focus on addressing the root cause of HASP-RT price differences.

J.P. Morgan appreciates the opportunity to provide these comments.