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May 23, 2008

The Honorable Kimberly D. Bose  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, DC 20426

**Re: California Independent System Operator Corporation  
Docket Nos. ER06-615-\_\_\_\_  
and ER08-\_\_\_\_ - 000**

## **MRTU Tariff Amendment to Remove “DEC Bidding” Rule**

Dear Secretary Bose:

Pursuant to Section 205 of the Federal Power Act (“FPA”),<sup>1</sup> 16 U.S.C. § 824d, and Section 35.13 of the regulations of the Federal Energy Regulatory Commission (“FERC” or the “Commission”), 18 C.F.R. § 35.13 (2007), the California Independent System Operator Corporation (“CAISO”) respectfully submits for filing an original and five copies of an amendment to the CAISO’s Market Redesign and Technology Upgrade (“MRTU”) Tariff. The CAISO submits this filing in order to remove from the MRTU Tariff the prohibition on certain decremental energy bids – the so-called “DEC Bidding Rule.” As discussed fully below, the CAISO proposes to remove the DEC Bidding Rule to ensure efficient operation of the MRTU market at start-up.

Two extra copies of this filing are also enclosed. Please stamp these copies with the date and time filed and return them to the messenger.

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<sup>1</sup> Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff, and in Part G (Definitions) of Appendix BB to the ISO Tariff.

## I. BACKGROUND ON THE DEC BIDDING RULE

Under the MRTU Tariff as filed, Scheduling Coordinators are prohibited from submitting Energy Bids in the Hour-Ahead Scheduling Process (“HASP”) or Real-Time Markets that are lower than the price of any cleared Bid submitted by that Scheduling Coordinator in the Day-Ahead Market.<sup>2</sup> This rule, known as the “DEC Bidding Rule,” does not apply to Ancillary Services or Residual Unit Commitment Bids that cleared the Day-Ahead Market or Bids that did not clear the Day-Ahead Market.<sup>3</sup>

The DEC Bidding Rule was put in place early in the MRTU policy process to prevent a limited version of what in the current market has been referred to as the “DEC game” from occurring under the CAISO’s MRTU market. In the current zonal market, the DEC game occurs when a Scheduling Coordinator strategically submits an infeasible energy schedule (a schedule that exceeds known transmission constraints) in the Day-Ahead Market knowing that the CAISO will be forced to dispatch their Real-Time decremental energy bids under uncompetitive market conditions to manage transmission constraints violated by their Day-Ahead schedule. The DEC game enables a Scheduling Coordinator to exercise market power by submitting very low (negative) decremental energy bids that when dispatched by the CAISO would result in excessive profits. Successfully playing the “DEC game” allows these Scheduling Coordinators to be paid for their Day-Ahead schedule and then be further compensated by the CAISO, in the case of a negative Real-Time decremental energy bid, to reduce their generation output in Real-Time.

Preventing the submission of infeasible day-ahead energy schedules was a major consideration in the development of the MRTU market design following the 2000-2001 electricity crisis. MRTU’s nodal market design structure incorporates a Full Network Model to ensure that schedules resulting from the Day-Ahead Market run are feasible. While the creation of the Full Network Model and the Day-Ahead Market process largely mitigate the threat of the “DEC game” under MRTU, the CAISO included the DEC Bidding Rule in the MRTU Tariff originally due to a concern about similar gaming opportunities in those infrequent situations where a transmission or generation outage occurs after the Day-Ahead Market closes but before the Real-Time Market closes that renders certain

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<sup>2</sup> MRTU Tariff, Section 30.5.1(b) (“Bid prices submitted by Scheduling Coordinator for Energy accepted and cleared in the IFM and scheduled in the Day-Ahead Schedule cannot be decreased.”)

<sup>3</sup> *Id.*

Integrated Forward Market (“IFM”) Schedules infeasible.<sup>4</sup> However, as discussed below, the removal of the DEC Bidding Rule is warranted because the CAISO has determined that the rule would not be effective in accomplishing its original objective and, moreover, could exacerbate the situations it was intended to address by generally discouraging the submission of decremental Energy Bids to the RTM.

## **II. REASONS FOR THIS AMENDMENT**

There are two primary reasons that the CAISO is filing to remove the DEC Bidding Rule language from the MRTU Tariff. First, the rule would not be effective in preventing the opportunistic exercise of local market power it was intended to address. A Scheduling Coordinator (“SC”) that wants to take advantage of an outage or derate that renders its accepted IFM Schedule infeasible can avoid the DEC Bidding Rule by simply submitting no DEC bid on that Schedule at all, which would have the same effect on the relevant LMPs as a -\$30 DEC bid. Second, the CAISO and its stakeholders have revisited concerns voiced by its consultant, LECG, about the legitimate business reasons why SCs may want to submit DEC bids to the RTM at lower prices than their Energy Bids that were accepted in the IFM, the potential of this rule to discourage the overall submission of DEC bids, and the potential negative effects of insufficient decremental bids in the Real-Time Market. Specifically, in light of these concerns, the CAISO has concluded that removal of the DEC Bidding Rule will not exacerbate the ability of SCs to play the opportunistic DEC game, but will encourage the submission of DEC bids to the RTM, which will in turn lead to more efficient operation of the market, avoid unnecessary uneconomic adjustments, and mitigate the price outcomes that occur as a result of insufficient economic bids.

### **A. Ineffectiveness of the DEC Bidding Rule in Preventing Opportunistic Market Power Exercise**

In accordance with one of the guiding principles behind its formulation, the MRTU design prevents the exercise of the infamous “DEC game” that arose during the 2000-2001 California energy crisis by adopting a Locational Marginal Pricing (“LMP”) framework which enforces all transmission constraints on an accurate Full Network Model (“FNM”) to create feasible schedules in all MRTU markets. Nevertheless, opportunities can arise for SCs to realize unwarranted profits in circumstances where a transmission or generation outage or derate that

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<sup>4</sup> The CAISO included language to implement the DEC Bidding Rule in the MRTU Tariff filed in Docket No. ER06-615 on February 9, 2006, which was accepted by the Commission in its order of September 21, 2006. *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 (2006).

occurs after the IFM Schedule is finalized renders an accepted IFM Schedule infeasible. Such infeasibility would have to be resolved by the CAISO in one of the Real-Time Market processes (the HASP or the Real-Time dispatch), and if competitive bids do not exist to resolve the infeasibility, the SC with the IFM Schedule in the critical location would be able to submit extremely low DEC bids and be paid for an opportunistic exercise of local market power. To prevent such possibilities, the February 2006 MRTU Tariff included the "DEC Bidding Rule," which prohibited SCs from submitting DEC bids to the RTM at prices lower than their accepted Energy Bids in the IFM.

Upon further consideration of this rule, the CAISO recognized what in retrospect may seem like an obvious loophole: the SC facing the market power opportunity could simply choose not to submit any DEC bids to the RTM at all, with the effect that its IFM Schedule would have to be DEC'd at the -\$30 per MWh bid floor price. Thus the DEC Bidding Rule would not be effective in preventing the behavior it was adopted to address. Moreover, in combination with the concern discussed below, namely the tendency of the rule to discourage legitimate DEC bidding behavior, the rule could in fact exacerbate the impact of opportunistic behavior by contributing to an overall dearth of DEC bids. The CAISO therefore proposes now to remove the DEC Bidding Rule from the MRTU Tariff for market start-up.

## **B. Ensuring Sufficient Economic Bids**

In its 2005 report, "Comments on the California ISO MRTU LMP Market Design," the consulting firm LECG identified unintended consequences that could result from the use of the DEC Bidding Rule in the MRTU market. LECG pointed out that there are legitimate business reasons why a supplier might need to submit DEC bids to the RTM at prices lower than the prices of their accepted IFM supply bids. LECG observed that the rule made no allowance for such legitimate needs and would therefore likely discourage Scheduling Coordinators from submitting DEC bids altogether. As a consequence, a dearth of DEC bids in the Real-Time Market could increase the likelihood that the CAISO would need to resort to uneconomic adjustments of schedules in Real-Time. Thus, to the extent there are insufficient economic DEC bids in the Real-Time Market, the CAISO would be adjusting resources that were scheduled in the Day-Ahead Market uneconomically by paying entities a default Real-Time offer price of -\$30/MWh, which is the Energy Bid floor.

Although the LECG report led the CAISO to recognize that some changes to the DEC Bidding Rule would be beneficial for market efficiencies, the potential changes discussed at that time would not have been simple to implement and the CAISO did not believe, initially, that complete removal of the rule without any

accompanying revisions would be appropriate for MRTU startup. In particular, at the time the MRTU Tariff was filed, insufficient DEC bids in Real-Time was not considered an operational concern because the Real-Time optimization will automatically determine an optimal dispatch, even if non-economic adjustments are necessary. Upon further consideration, however, the CAISO has recognized that there is no reason to retain a rule that could lead to smaller quantities of Real-Time DEC bids and greater reliance on uneconomic adjustment than would be the case without the rule, particularly when removal of the rule will be simple to implement and result in an overall simplification of the bidding rules, without any adverse consequences for the behavior the rule was intended to mitigate.

Removing the prohibition on DEC bids below those bids that cleared in the Day-Ahead Market would increase the likelihood that there will exist a sufficient amount of economic DEC bids, thereby enhancing the efficiency of the Real-Time Market. Without the DEC Bidding Rule in place, Market Participants will have a greater ability to adjust their resources in light of changing plant conditions after the close of the Day-Ahead Market, or to alter the mix of megawatts they offer for sale in the Real-Time Markets. Although elimination of the rule does eliminate a significant disincentive to Scheduling Coordinators to submit Real-Time DEC bids, the CAISO does not necessarily believe that removal of this rule is sufficient to ensure an optimally liquid Real-Time DEC bid market, and is continuing to explore additional measures for implementation subsequent to MRTU start-up.

### **C. The CAISO Will Closely Monitor the Limited Opportunities for DEC Gaming Under MRTU**

Importantly, removing the DEC Bidding Rule does **not** increase the risk associated with the DEC game. The overall design of the MRTU market is the primary protective measure against the DEC gaming that the CAISO has observed in the current zonal market design. However, as noted above, the CAISO previously expressed a concern that the MRTU market design would leave a limited opportunity for such gaming in those infrequent situations where a transmission outage occurs after the Day-Ahead Market but before the Real-Time Market closes. Cognizant of the circumstances that such outages or derates would create, the CAISO will closely monitor all bidding practices surrounding such situations and consider tariff modifications to address any problems that arise.

### **III. PROPOSED MRTU TARIFF CHANGES**

The DEC Bidding Rule resided in Section 30.5.1(b) of the MRTU Tariff. Accordingly, the revised tariff sheets attached to this filing reflect a change to this section to remove the DEC Bidding Rule and replace it with language that does not limit the Bid prices submitted by Scheduling Coordinators to the RTM for Energy accepted and cleared in the IFM and scheduled in the Day-Ahead Schedule, beyond the requirement to comply with the applicable Bid Cap and Bid Floor values.

### **IV. STAKEHOLDER AND MSC SUPPORT**

The CAISO conducted a thorough process to gain stakeholder feedback and support for this amendment. The official stakeholder process began with a February 1, 2008 issue paper entitled "Modifying the DEC Bidding Activity Rule on Day Ahead Schedules." A meeting with stakeholders and the Market Surveillance Committee followed on February 8 to discuss this issue. Stakeholders filed written comments a week later. On March 7, the CAISO published a straw proposal for removing or otherwise modifying the DEC Bidding Rule. A stakeholder conference call followed with a second round of written comments filed with the CAISO a week later. On April 14, the CAISO posted a revised straw proposal on this issue. Again, the CAISO held a conference call with stakeholders a week later and then accepted a third round of written comments. On May 9, draft tariff language for the instant filing was posted for stakeholder review. A comment date for the tariff language was set for May 13; no comments were filed. On May 21, 2008, the CAISO Board approved removal of the DEC Bidding Rule.

Importantly, the decision to remove the DEC Bidding Rule is largely non-controversial. The comments that stakeholders have filed with the CAISO have been supportive. In addition, the CAISO's Market Surveillance Committee issued a formal opinion on May 7 supporting the removal of the DEC Bidding Rule. The CAISO's Department of Market Monitoring is similarly in favor of this filing. Finally, removal of this rule does not affect either the CAISO or Market Participants' software.

### **V. EFFECTIVE DATE**

As the Commission is aware, the CAISO will not be implementing MRTU on March 31, 2008, the proposed effective date included in the CAISO's Fourth Replacement Electric Tariff filed on December 21, 2007 in Docket No. ER08-367. As discussed in the monthly MRTU status reports filed in ER06-615, the

CAISO will not be able to announce a new proposed effective date until the CAISO resumes its market simulation activities and is confident that the MRTU software is operating successfully. At this time, the CAISO is on track for a Fall 2008 implementation with a target date of October 1, 2008. Accordingly, the CAISO is filing clean tariff sheets without indicating a proposed effective date and, therefore, requests waiver of Order No. 614 and applicable provisions of Section 35.9 of the Commission's regulations. The CAISO understands that in the absence of a proposed effective date the Commission is not compelled to take any action within the 60-day time frame prescribed by the Federal Power Act. Nevertheless, the CAISO requests the Commission issue an order in this docket within the 60-day time period or as soon thereafter as possible. A timely order will allow for a more orderly transition to MRTU for the CAISO and its Market Participants and, in this instance, remove regulatory risk associated with disabling a component of the MRTU design previously accepted by the Commission.

## **VI. COMMUNICATIONS**

Communications regarding this filing should be addressed to the following individuals, whose names should be placed on the official service list established by the Secretary with respect to this submittal:

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## **VII. SERVICE**

The CAISO has served copies of this transmittal letter, and all attachments, on the California Public Utilities Commission, the California Energy Commission, the California Electricity Oversight Board, all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff, and all parties in Docket No. ER06-615. In addition, the CAISO is posting this transmittal letter and all attachments on the CAISO website.

## VIII. ATTACHMENTS

The following documents, in addition to this transmittal letter, support the instant filing:

- |              |   |
|--------------|---|
| Attachment A | Revised MRTU Tariff Sheets – Clean  |
| Attachment B | Revised MRTU Tariff Sheets - Blackline  |
| Attachment C | Opinion of the Market Surveillance Committee on Elimination of the DEC Bidding Rule |
| Attachment D | Revised Straw Proposal on Removal of DEC Bidding Rule from MRTU Tariff              |

## IX. CONCLUSION

For the foregoing reasons, the CAISO respectfully requests that the Commission approve this tariff revision as filed. Please feel free to contact the undersigned if you have any questions concerning this matter.

Respectfully submitted,



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**ATTACHMENT A**

**MRTU TARIFF SHEETS - CLEAN**

**Attachment A – Clean Sheets**  
**DEC Bidding Rule Amendment Filing**  
**4<sup>th</sup> Replacement CAISO Tariff (MRTU)**  
**May 23, 2008**

option shall be based on the relevant cost information of the particular resource, which will be provided to the CAISO by the Scheduling Coordinator and maintained in the Master File. In the event that the Scheduling Coordinator for a unit does not provide sufficient data for the CAISO to determine the unit's Proxy Costs, the CAISO will assume that the unit's Start-Up Costs and Minimum Load Costs are zero.

- (2) **Registered Cost Option.** Under the Registered Cost option, the Scheduling Coordinator may register values of its choosing for Start-Up Costs and Minimum Load Costs in the Master File subject to the maximum limit specified in Section 39.6.1.6. For a resource to be eligible for the Registered Cost option there must be sufficient information in the Master File to calculate the Proxy Cost option. The Start-Up Cost and Minimum Load Cost values utilized in the CAISO Markets Processes will be these pre-specified values and will be fixed for six months in the Master File unless the resource's costs, as calculated pursuant to the Proxy Cost option, exceed the Registered Cost option, in which case the Scheduling Coordinator may elect to switch to the Proxy Cost option for the balance of the six-month period.

## **30.5 Bidding Rules.**

### **30.5.1 General Bidding Rules.**

- (a) All Energy and Ancillary Services Bids of each Scheduling Coordinator submitted to the DAM for the following Trading Day shall be submitted at or prior to 10:00 a.m. on the day preceding the Trading Day, but no sooner than seven (7) days prior to the Trading Day. All Energy and Ancillary Services Bids of each Scheduling Coordinator submitted to the HASP for the following Trading Day shall be

submitted starting from the time of publication, at 1:00 p.m. on the day preceding the Trading Day, of DAM results for the Trading Day, and ending seventy-five (75) minutes prior to each applicable Trading Hour in the RTM. The CAISO will not accept any Energy or Ancillary Services Bids for the following Trading Day between 10:00 a.m. on the day preceding the Trading Day and the publication, at 1:00 p.m. on the day preceding the Trading Day, of DAM results for the Trading Day;

- (b) Bid prices submitted by a Scheduling Coordinator for Energy accepted and cleared in the IFM and scheduled in the Day-Ahead Schedule may be increased or decreased in the HASP. Bid prices for Energy submitted but not scheduled in the Day-Ahead Schedule may be increased or decreased in the HASP. Incremental Bid prices for Energy associated with Day-Ahead AS or RUC Awards in Bids submitted to the HASP may be revised. Scheduling Coordinators may revise ETC Self-Schedules for Supply only in the HASP to the extent such a change is consistent with TRTC Instructions provided to the CAISO by the Participating TO in accordance with Section 16. Scheduling Coordinators may revise TOR Self-Schedules for Supply only in the HASP to the extent such a change is consistent with TRTC Instructions provided to the CAISO by the Non-Participating TO in accordance with Section 17. Energy associated with awarded Ancillary Services capacity cannot be offered in the HASP or Real-Time Market separate and apart from the awarded Ancillary Services capacity;
- (c) Scheduling Coordinators may submit Energy, AS and RUC Bids in the DAM that are different for each Trading Hour of the Trading Day;

**ATTACHMENT B**

**MRTU TARIFF SHEETS – BLACKLINE**

**Attachment B – Blacklines**

**DEC Bidding Rule Amendment Filing**

**4<sup>th</sup> Replacement CAISO Tariff (MRTU)**

**May 23, 2008**

## 30.5

### Bidding Rules.

#### 30.5.1

#### General Bidding Rules.

- (a) All Energy and Ancillary Services Bids of each Scheduling Coordinator submitted to the DAM for the following Trading Day shall be submitted at or prior to 10:00 a.m. on the day preceding the Trading Day, but no sooner than seven (7) days prior to the Trading Day. All Energy and Ancillary Services Bids of each Scheduling Coordinator submitted to the HASP for the following Trading Day shall be submitted starting from the time of publication, at 1:00 p.m. on the day preceding the Trading Day, of DAM results for the Trading Day, and ending seventy-five (75) minutes prior to each applicable Trading Hour in the RTM. The CAISO will not accept any Energy or Ancillary Services Bids for the following Trading Day between 10:00 a.m. on the day preceding the Trading Day and the publication, at 1:00 p.m. on the day preceding the Trading Day, of DAM results for the Trading Day;
- (b) Bid prices submitted by a Scheduling Coordinator for Energy accepted and cleared in the IFM and scheduled in the Day-Ahead Schedule ~~cannot be decreased~~ may be increased or decreased in the HASP. Bid prices for Energy submitted but not scheduled in the Day-Ahead Schedule may be increased or decreased in the HASP. Incremental Bid prices for Energy associated with Day-Ahead AS or RUC Awards in Bids submitted to the HASP may be revised. Scheduling Coordinators may revise ETC Self-Schedules for Supply only in the HASP to the extent such a change is consistent with TRTC Instructions provided to the CAISO by the Participating TO in accordance with Section 16. Scheduling Coordinators may revise TOR Self-Schedules for Supply only in the HASP to the extent such a change is consistent with TRTC Instructions provided to the CAISO by the Non-Participating TO in accordance with Section 17. Energy associated with awarded Ancillary Services capacity cannot be offered in the HASP or Real-Time Market separate and apart from the awarded Ancillary Services capacity;

- (c) Scheduling Coordinators may submit Energy, AS and RUC Bids in the DAM that are different for each Trading Hour of the Trading Day;
- (d) Bids for Energy or capacity that are submitted to one CAISO Market, but are not accepted in that market are no longer a binding commitment and Scheduling Coordinators may submit Bids in a subsequent CAISO Market at a different price; and
- (e) The CAISO shall be entitled to take all reasonable measures to verify that Scheduling Coordinators meet the technical and financial criteria set forth in Section 4.5.1 and the accuracy of information submitted to the CAISO pursuant to this Section 30.

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## **ATTACHMENT C**

### **CAISO Market Surveillance Committee Opinion on Removal of DEC Bidding Rule**



California ISO  
Your Link to Power

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**Revised Straw Proposal for**

**The**

**DEC Bidding Activity Rule**

**April 14, 2008**

*(This is the third CAISO paper on this issue. An Issue Paper that was posted on February 1, 2008 and a Straw Proposal was posted on March 7, 2008. These are located at: <http://www.caiso.com/1f60/1f60e3f42e760.pdf>)*

# Revised Straw Proposal for The DEC Bidding Activity Rule

## Table of Contents

1. Executive Summary .....	3
2. Process and Proposed Timetable .....	5
3. Stakeholder Comments on the CAISO’s Straw Proposal for the DEC Bidding Rule .....	7
4. Revised Straw Proposal for the DEC Bidding Rule.....	8
4.1. <i>For MRTU Startup: Switch Off the DEC Bidding Rule</i> .....	8
4.2. <i>For Market Release 1A: Modify the DEC Bidding Rule</i> .....	9
5. Next Steps .....	12

## 1. Executive Summary

The "DEC Bidding Rule" as currently specified in the MRTU Tariff prohibits a Scheduling Coordinator from submitting decremental Energy Bids relative to their final Day Ahead Energy Schedules in the HASP or Real Time Markets that are lower than the bid prices that had been offered by that Scheduling Coordinator and which cleared in the Day-Ahead Integrated Forward Market (IFM).

This rule was designed and adopted in Section 30.5.1 (b) of the MRTU Tariff filed in February 2006 with the intention of preventing gaming opportunities when transmission outages or derates occur that could render an accepted Day Ahead Energy Schedule infeasible in the time period between the close of the Day Ahead Market and Real Time.

On March 7, 2008, the CAISO posted a paper explaining the following Straw Proposal:

- Switch off the currently established rule for MRTU start-up because it would be ineffective and may in fact be counter-productive by contributing to a dearth of DEC bids in the Real Time Market, which could lead to less competitive outcomes. With the existing rule switched off, Scheduling Coordinators would face no specific limitations on their ability to submit decremental bids on their final Day Ahead Energy Schedules in the HASP or Real Time Markets.
- For Market Release 1A, retain the MRTU start-up approach (*i.e.* DEC bidding rule disabled) and do not impose any new restrictions on the ability of Scheduling Coordinators to submit decremental bids on their final Day Ahead Energy Schedules in the Real Time Markets.

In addition, implement a new mechanism whereby economic Energy Bids cleared in the IFM would be transferred to the HASP/RTM to be used as "default" decremental Energy Bids in cases when the Scheduling Coordinator does not explicitly submit a new decremental Energy Bid on its cleared Day Ahead Energy Schedule.

This new mechanism would effectively change the current HASP/RT decremental bid market from an "opt-in" design to an "opt-out" design for those final Day Ahead Schedules that were cleared based on economic Energy Bids. The new mechanism would not affect final Day Ahead Energy Schedules that were cleared based on submitted Self Schedules.

By requiring the Scheduling Coordinator to explicitly "opt out" of the Real Time DEC bid market and defaulting to the Scheduling Coordinator's cleared Day Ahead Energy bid curves when no Real Time DEC bid is submitted, the CAISO expects to see a more liquid DEC market in the Real Time, thus reducing the likelihood of uneconomic adjustments at the bid floor of -\$30/MWh.

The CAISO is pursuing policy resolution of the first part of this Proposal – switching off the existing DEC Bidding Rule upon MRTU start-up – at the May 21-22 meeting of the CAISO Board of Governors. Assuming Board approval, the CAISO would file a proposal at FERC to modify the MRTU Tariff so that the DEC Bidding Rule would not be in effect upon MRTU start-up.

For the second part of this Proposal targeted for Market Release 1A – the use of the accepted Day Ahead Energy Bid as a default bid in the Real Time Market if the Scheduling Coordinator does not explicitly “opt out” by submitting a new bid – the CAISO offers this Revised Straw Proposal and seeks further stakeholder input and discussion on the design for this Real Time bidding process. There are two significant changes explained within this Revised Straw Proposal (compared to the March 7 Straw Proposal):

1. This Revised Proposal seeks to promote a fuller explanation of the flexibility that Scheduling Coordinators would have, in the Real Time Market, under this proposed “opt out” approach using the cleared Day Ahead Energy Bid curve as a default. Specifically, the CAISO now proposes that, under the “opt out” approach proposed for Market Release 1A, Scheduling Coordinators could have the option to convert their final Day Ahead Energy Schedule into an accepted Day Ahead Self Schedule for purposes of the HASP and Real Time Markets. This would ensure as much protection in the Real Time Market for a cleared Day Ahead Energy schedule as the current MRTU Tariff rules provides, as long as the Scheduling Coordinator acts to “opt-out” of the new default DEC bid mechanism by making this election in its Real Time Market bid submission.

Thus this Revised Straw Proposal would allow flexibility for a Scheduling Coordinator with a final Day Ahead Energy Schedule that was based on a cleared economic Energy Bid to choose to:

- a) submit a DEC economic bid in the Real Time Market,
  - b) convert its cleared Day Ahead schedule into an accepted Day Ahead Self Schedule within the Real Time Market, or
  - c) take no action at all in the Real Time Market whereupon, by default, the CAISO systems would move the bid curves that had previously cleared the Day Ahead Market into the Real Time Market.
2. The CAISO also proposes to build software capability to limit the time period for Real Time DEC bids to a more limited window of opportunity, instead of allowing DEC bids throughout the Real Time Market. However, the CAISO would not at this time seek tariff authority to impose this limitation.

Building this capability in advance would enable the CAISO to implement this bidding window relatively quickly if gaming became problematic. Of course, if the CAISO did decide to implement such a DEC bidding window at a later time, it would conduct a Stakeholder process on this matter and seek the approval of its Board and FERC prior to implementation.

The CAISO will discuss this Revised Straw Proposal at a stakeholder conference call on April 21; an additional round of written comments will be requested by April 28. The CAISO staff will present this conceptual design for this Release 1A feature at the July meeting of the CAISO Board of Governors.

## **2. Process and Proposed Timetable**

The CAISO seeks to bifurcate the resolution of this DEC Bidding issue and extend the planned time for review of the Release 1A component to allow additional discussion with stakeholders.

- The CAISO will seek approval from the CAISO Board of Governors in May on the proposal to switch off the DEC Bidding Rule upon MRTU Release 1.
- The CAISO proposes to target the July Board meeting for resolution of the Market Release 1A proposal to establish a new default when a Scheduling Coordinator with a cleared Day Ahead bid does not submit a bid in the Real Time Market. This would allow further time for stakeholder review of this component of this DEC Bidding issue.

Currently the CAISO is requesting at least one more round of written comments from stakeholders on this Revised Straw Proposal, following a conference call discussion on April 21.

The CAISO anticipates further discussion and requests for written comments as a draft "Final Proposal" is developed for the Market Release 1A component of this issue by the July Board meeting.

The following table summarizes the revised timetable for resolving this issue:

<b>February 1, 2008</b>	Issue paper "Modifying the DEC Bidding Activity Rule on Day Ahead Schedules" posted at: <a href="http://www.caiso.com/1f60/1f60e3f42e760.pdf">http://www.caiso.com/1f60/1f60e3f42e760.pdf</a>
<b>February 8</b>	MSC/Stakeholder meeting
<b>February 15</b>	Initial stakeholder comments posted at: <a href="http://www.caiso.com/1822/1822931f287d0.html">http://www.caiso.com/1822/1822931f287d0.html</a>
<b>March 7</b>	Straw Proposal posted
<b>March 17</b>	Stakeholder conference call
<b>March 24</b>	Stakeholder comments due (email to: <a href="mailto:DWithrow@caiso.com">DWithrow@caiso.com</a> )
<b>April 14</b>	"Revised Straw Proposal on DEC Bidding Rule" posted
<b>April 21</b>	Stakeholder conference call
<b>April 30</b>	Stakeholder comments due (email to: <a href="mailto:DWithrow@caiso.com">DWithrow@caiso.com</a> )
<b>May 7 (tentative)</b>	Draft " <i>Final Proposal on DEC Bidding Rule</i> " posted with additional stakeholder discussion at a date to be determined.
<b>May 21-22, 2008</b>	Presentation (Decision) to CAISO Board of Governors ( <i>on the proposal to switch off the current DEC Bidding Rule upon MRTU start-up.</i> )
<b>July 9-10, 2008</b>	Presentation (Decision) to the CAISO Board of Governors ( <i>on the Release 1A proposal for additional bidding options in the Real Time Market.</i> )

In addition, the CAISO is asking the Market Surveillance Committee (MSC) to develop a written opinion on the CAISO's "Final Proposal" on the Market Release 1A component of this Real Time bidding issue by the scheduled July meeting of the CAISO Board of Governors. The CAISO will schedule separate conference calls and notify stakeholders *via* Market Notices for the MSC to discuss a draft and then finalize its written opinion prior to the July Board meeting.

### **3. Stakeholder Comments on the CAISO's Straw Proposal for the DEC Bidding Rule**

This section summarizes the second round of comments submitted by stakeholders following the March 17 discussion of the CAISO initial Straw Proposal (posted March 7) to switch off the DEC Bidding Rule for MRTU start-up and

These comments are posted at: <http://www.caiso.com/1822/1822931f287d0.html>.

#### **CPUC staff:**

- Tentatively supports switching off the DEC Bidding Rule upon MRTU start-up. The CAISO should consider a market power mitigation tool in case gaming with DEC bids is detected.
- CPUC staff tentatively supports the proposed default to pass through cleared IFM bids in the absence of Real Time Market bids. Further discussion should be held on the differences between Day Ahead Self-Schedules, Self-Schedules into the Real Time Market and accepted IFM bids that are converted to Self-Schedules.

#### **Dynegy:**

- Supports switching off the DEC Bidding Rule upon MRTU start-up.
- Does not support automatically carrying over the Day Ahead energy bid curve into the Real Time Market. Scheduling Coordinators should be allowed to voluntarily offer Real Time DEC bids without being forced to over-ride Day Ahead energy bids.

#### **PG&E:**

- Tentatively supports switching off the DEC Bidding Rule upon MRTU start-up.
- Still reviewing the "opt-out" approach and the impacts upon PG&E's scheduling operation.

#### **Powerex:**

- Supports switching off the DEC Bidding Rule upon MRTU start-up.
- Does not support the Market Release 1A proposal to automatically convert Day Ahead schedules to Real Time Market DEC bids using the Day Ahead bid curves.

Cleared Day Ahead schedules on the interties require the Scheduling Coordinator to e-tag the schedules.

**SCE:**

- Supports eliminating the DEC Bidding Rule upon MRTU start-up. CAISO should reflect this change as soon as possible in the MRTU market simulation process.
- Supports the proposal to “forward” Day Ahead bid curves so that the default for the Real Time Market, if a Scheduling Coordinator does not submit a bid, is the IFM awarded bids. The CAISO should consider “bidirectional” mitigation where, under noncompetitive situations, DEC bids could be mitigated upwards.

**WPTF:**

- Supports switching off the DEC Bidding Rule upon MRTU start-up.
- Opposes the proposal to require Scheduling Coordinators to “opt out” of providing decremental energy bids instead of “opting in” as they do now

## **4. Revised Straw Proposal for the DEC Bidding Rule**

### **4.1. For MRTU Startup: Switch Off the DEC Bidding Rule**

The currently established DEC Bidding Rule prohibits a Scheduling Coordinator from submitting Energy Bids in the HASP or Real Time Markets that are lower than the Bid prices submitted by that Scheduling Coordinator in the Day Ahead Market for energy that has cleared in the Day Ahead.

This Revised Straw Proposal reiterates the CAISO’s recommendation to switch off the DEC Bidding Rule when the LMP markets begin.

This means that there would be no restriction on DEC bids parties may submit to the Real Time Market associated with quantities of energy accepted in the IFM, other than the normal bid caps. CAISO staff believes the best course of action is to avoid the possibility of unintended consequences from this currently established Rule – specifically, a dearth of DEC bids in the Real Time Market and the increased likelihood of \$-30/MWh prices – by switching off the DEC Bidding Rule as soon as possible, preferably upon MRTU startup.

The CAISO’s Department of Market Monitoring supports switching off this DEC Bidding Rule upon MRTU startup.

The CAISO will seek approval from the CAISO Board of Governors (at its May 21-22 meeting) to file a tariff change to switch off the DEC Bidding Rule for MRTU start-up. The CAISO will continue work very closely with market participants in the market simulation to reflect this policy.

#### **4.2. For Market Release 1A: Modify the DEC Bidding Rule**

For further stakeholder discussion, the CAISO offers the following revised proposal to modify the DEC Bidding rule for Market Release 1A in the following way:

- The CAISO proposes NOT to limit the range or the time period by which entities could submit DEC bids. This would be consistent with the MRTU start-up position (*i.e.* DEC bidding rule switched off), assuming the proposal in the previous section is adopted.
- If a Scheduling Coordinator does not submit any DEC bids associated with its accepted IFM energy schedule, then economic bids submitted and cleared in the Day Ahead Market would automatically flow into the Real Time Market and would be included with DEC bids that are submitted solely into the Real Time Market. This is in contrast to current MRTU Tariff provisions and functionality, which turn accepted Day-Ahead Energy Bids in to the equivalent of accepted Day Ahead "Self-Schedules" for purposes of the Real Time Market.

Under current MRTU Tariff provisions, such accepted Day Ahead Energy Schedules – irrespective of whether they were based on submitted Economic Bids or submitted Self Schedules – have higher protection against adjustment in the Real Time Market. With this enhancement to the March 7 CAISO proposal, the current proposal reduces simply to the conversion of what was originally an "opt-in" Real Time DEC bid market into an "Opt-out" Real Time Market, with no loss of Day Ahead Energy schedule protection against Real Time adjustment if that is what the Scheduling Coordinator desires.

By changing from an opt-in to an opt-out Real Time DEC Bid market, the Real Time Market backstop for energy schedules that economically cleared the IFM would change. Instead of the backstop established for MRTU start-up which automatically converts cleared Day Ahead bids into Self Schedules through the Real Time Market, the proposed backstop -- when a Scheduling Coordinator with cleared bids in the Day Ahead Market does not submit bids in the Real Time Market -- would be the bid curves that cleared the Day Ahead Market. The CAISO would then be able to follow these bid curves downward as part of the Real Time DEC market.

The appeal of this approach, from a market design standpoint, is that it takes advantage of all the information submitted by the Scheduling Coordinator in the Day Ahead bid curve. The bid curve gives a whole range of prices and quantities and reflects the Scheduling Coordinator's trade-offs given its most current and accurate information as of the time of submission. By contrast, moving only the cleared quantity and price from the Day Ahead market into Real Time gives only

this one point of information rather than the whole curve submitted by the Scheduling Coordinator in the Day Ahead Market.

Given that the MRTU market design does include this function of passing information from the Day Ahead Schedule to the Real Time optimization, we face the question of which set of information – the bid curve, or the cleared price and quantity from the Day Ahead – should be the default to move into the Real Time. This proposal recommends that the entire curve be carried into Real Time as it embodies so much more information reflecting Scheduling Coordinators' trade-offs and preferences.

- The CAISO staff expects that a deeper and more liquid market for Real Time DEC bids would likely ensue, thus greatly reducing the likelihood that the Real Time Market would run out of DEC bids which would force the CAISO to resort to uneconomic adjustments.
- Accepted Day Ahead Self Schedules would remain protected through Real Time because no bid curve exists upon which to base a default DEC bid. Absent the submission by the Scheduling Coordinator of a DEC bid in the Real Time Market, Self-Schedules cleared in the Day Ahead would remain protected through Real Time.
- With the enhancement proposed in the current proposal, final Day Ahead schedules based on accepted economic bids could be protected in the Real Time Market to the same degree as they would be under the current MRTU Tariff, which makes them equivalent to accepted Day Ahead Self Schedules. The Scheduling Coordinator could also, as an alternative, submit a very low or negative DEC bid (as low as -\$30/MWh) to reduce its chances of being decremented in Real Time but without opting for the full protection on an accepted Self Schedule.

**This Revised Straw Proposal adds the following features for additional stakeholder discussion:**

- **SCs would have options for what information is passed from the Day Ahead to the Real Time Market:** This Revised Straw Proposal would allow flexibility for Scheduling Coordinators to choose to:
  - 1) convert their cleared Day Ahead schedule into a Self Schedule within the Real Time Market,
  - 2) submit a DEC economic bid in the Real Time Market, or
  - 3) take no action at all in the Real Time Market whereupon, by default, the CAISO systems would move the bid curves that had previously cleared the Day Ahead Market into the Real Time Market.

- **Capability to Limit the Time Period for DEC Bidding:** The CAISO also proposes to build capability within the software changes being developed with Market Release 1A for limiting the time period for Real Time DEC bids, instead of allowing DEC bids throughout the Real Time Market. This would allow easier and likely quicker implementation if, in the future, a new policy was established to limit submission of Real Time Market DEC bids to a two hour time window (such as 1:00 to 3:00 pm the day before the operating day).

It should be emphasized that the CAISO is not proposing now to seek tariff authority to impose this limitation. This Revised Straw Proposal reiterates that market participants should face no limits on DEC bids other than the established rules for submitting bids in the Real Time Market.

The purpose of this proposed software enhancement would be for the CAISO to have technical capability if, after Market Release 1A is implemented, the CAISO sought to change policy and seek FERC's approval to limit DEC bids to a shortened time period in order to minimize gaming opportunities. Building such software capability would have no impact on the ability of market participants to submit DEC bids in the Real Time Market and probably need not be considered now as a policy matter. The CAISO mentions building this capability to encourage a thorough stakeholder discussion, but emphasizes that any future policy or tariff change that would have an impact to limit DEC bidding would be reviewed with stakeholders and subject to FERC approval.

A purpose for shortening the window would be to lower the probability that a Market Participant could engage in a variant of the "DEC game" by leveraging information about a transmission outage. A transmission outage would have to occur within the re-bid window after the close of the Day Ahead market in order to enable a participant to take advantage of that information when submitting bids into the HASP and Real Time Markets. The limited duration of the re-bid window is intended to reduce the probability of such a gaming opportunity.

Note again that this re-bid window is not proposed for current implementation, but is rather recommended by the Department of Market Monitoring (DMM) as a safety net to be built but not used unless the above described gaming becomes prevalent and problematic for efficient market outcomes and operations. If DEC market power is a problem under the initial release of MRTU, DMM would seek to have the re-bid window imposed earlier than Market Release 1A.

## 5. Next Steps

The CAISO will conduct a conference call on April 21 to review this Revised Straw Proposal on the DEC Bidding Rule as well as the draft Final Proposal on the Pricing Logic Under Flexible Modeling of Constrained Output Generating Units. Stakeholders are encouraged to participate in this discussion. The time and number for this conference call will be available on the CAISO calendar at:

<http://www.aiso.com/meetings/index.cgi/>

The CAISO requests written comments from stakeholders on this Revised Straw Proposal by April 30 to [DWithrow@caiso.com](mailto:DWithrow@caiso.com).

Following the stakeholder discussion on April 21, a suggested template for stakeholder written comments will be posted at: <http://www.aiso.com/1822/1822931f287d0.html>.

## **ATTACHMENT D**

### **Revised Issue Paper on DEC Bidding Rule**

**Opinion on “The DEC Bidding Activity Rule under MRTU”**

by

**Frank A. Wolak, Chairman**

**James Bushnell, Member**

**Benjamin F. Hobbs, Member**

**Market Surveillance Committee of the California ISO**

**May 7, 2008**

**1. Introduction**

The California Independent System Operator (CAISO) has asked the Market Surveillance Committee (MSC) to comment on its DEC Bidding Activity Rule proposal.<sup>1</sup> The “DEC Bidding Rule” as currently written in the Market Redesign and Technology Upgrade (MRTU) tariff prohibits a Scheduling Coordinator (SC) from submitting decremental (DEC) energy bids to supply less energy than their final Day-Ahead (DA) schedule in the Hour-Ahead Scheduling Process (HASP) or Real-Time (RT) market that are lower than the bid prices offered by that SC and accepted in DA Integrated Forward Market. For example, if a generation unit owner offers 100 MWh at a bid price of \$50/MWh, an additional 50 MWh for a bid price of \$55/MWh and 50 MWh more at a bid price of \$70/MWh and 175 MWh is accepted from this unit in the DA-IFM at a price of \$70/MWh, then this generation unit owner can offer 25 MWh of DEC energy at \$70/MWh or more, additional 50 MWh of DEC energy at \$55/MWh or more and finally up to 100 MWh of DEC energy for \$50/MWh or more into the HASP or RT market under this tariff provision.

This DEC Bidding Rule was designed to prevent suppliers from taking advantage of transmission or generation outages or derates that occur between the close of the DA market and real-time system operation that could make an accepted DA schedule infeasible. In the above example, if a transmission outage made 75 MWh of the 175 MWh DA schedule accepted in the IFM infeasible and the generation unit owner knew this immediately following the close of the DA market, this supplier could submit an extremely low DEC energy bid, to the bid floor of -\$30/MWh, and still be accepted in the HASP or RT market if it is the only generation unit able to meet this DEC energy need.

The CAISO management has recommended suspension of the implementation of this DEC Bidding Rule at the start of MRTU and has asked the MSC to comment on this. The MSC discussed the DEC Bidding Rule and heard stakeholder comment during the February 8, 2008 joint MSC/Stakeholder meeting. During this meeting, several MSC members argued that the costs of imposing this restriction on decremental energy bids was not justified by the market efficiency benefits that would result from keeping it in place. These MSC members urged the CAISO to start MRTU without these restrictions in place, and only impose them if market outcomes justified their imposition, which is the proposal the CAISO has now adopted.

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<sup>1</sup> This proposal and stakeholder comments are summarized in the documents “Straw Proposal for The DEC Bidding Activity Rule,” March 7, 2008, and “Revised Straw Proposal for The DEC Bidding Activity Rule,” April 14, 2008. Both are available at [www.caiso.com/1fb1/1fb184c166370.html](http://www.caiso.com/1fb1/1fb184c166370.html).

## **2. Rationale for Suspension of DEC Bidding Rule**

The intent of the DEC Bidding Rule is to prevent the so-called “DEC game” under MRTU, where a supplier over-schedules in the DA market and then sells this energy back in the HASP or RT market at a lower price. Because MRTU uses a full network model for the DA-IFM, the opportunities for this DEC game to occur are confined to periods when transmission or other operating constraints change after the DA market closes and the RT market starts. This is different from the current zonal market design where DA energy schedules are accepted subject only to inter-zonal transmission capacity constraints. Intra-zonal transmission capacity constraints are not recognized in the current DA scheduling process even though these constraints must be satisfied in real-time system operation. Consequently, circumstances when the DEC game is profitable are significantly less likely to occur under MRTU than they are under the current market design.

Moreover, a sustained transmission or generation outage that requires revising the transmission network model used in the DA-IFM, HASP and RT markets should not increase the opportunities generation unit owners have to engage in this “DEC game.” Infeasible schedules relative to this revised network model will not be accepted in the DA-IFM. Generation unit owners will therefore be unable to over-schedule over multiple days relative to expected real-time production from their generation units because the revised network model in the DA-IFM will prevent this from occurring.

As noted earlier, suspending the DEC Bidding Rule allows generation unit owners to modify their DEC bids to take advantage of a change in transmission or other operating constraints on their generation unit between the close of the DA-IFM and the RT market. However, even with the DEC Bidding Rule in place suppliers can still take advantage of this change in operating constraints. A supplier that knows that one of its generation units needs to reduce its DA schedule because of this change in operating conditions can achieve virtually the same outcome as submitting a very low DEC energy bid by not submitting a DEC energy bid. Under these circumstances the HASP and RT market would put a default DEC energy bid in for this unit at the bid floor of  $-\$30/\text{MWh}$ . If this unit was the only one available to meet the DEC energy need, then this bid would be accepted and would set, at most, a  $-\$30/\text{MWh}$  price at that location. In this way, the supplier would be able to take maximum advantage of its knowledge that its unit is the only one available to meet this DEC energy need.

The above logic demonstrated that the DEC Bidding Rule does not prevent a generation unit owner from accomplishing virtually the same market outcome as submitting a low DEC energy bid that violates the DEC Bidding Rule. In addition, a number of stakeholders have argued that implementing the DEC Bidding Rule increases the likelihood that generation unit owners do not submit DEC bids into the HASP or RT market. This increases the likelihood that the CAISO will have to rely on default DEC bids to meet its decremental energy needs.

If market participants submit fewer DEC energy bids, system reliability problems and market inefficiencies can result. With fewer DEC energy bids above the  $-\$30/\text{MWh}$  default bid floor level, the CAISO operators will have to rely on generation units that did not submit DEC energy bids to meet their DEC energy needs. Some of these units may truly be unable to reduce

their DA schedules and must therefore refuse a DEC instruction issued by the CAISO. The CAISO operators may have a difficult time determining in advance of RT system operation which units are physically unable to respond to these DEC instructions. Consequently, the CAISO operators may be forced to call on additional units to provide DEC energy just to get the MWh they actually need. This is also likely to increase the cost of managing the system in real-time because DEC energy prices will be at least -\$30/MWh at those locations in the network.

We believe that a superior balance of the costs and benefits of different means to manage the risk that suppliers can take advantage of changes in the network model between the DA and RT is to allow suppliers to submit DEC bids that might violate the DEC Bidding Rule constraint. Under these circumstances, suppliers will have no incentive not to submit DEC energy bids above the -\$30/MWh bid floor. Although RT energy prices at these locations are likely to be significantly lower than the DA price during those periods when the network model changes between DA and RT, the advantage of this approach is that CAISO operators will have sufficient DEC energy bids at or below the -\$30/MWh DEC bid floor to manage the system. These DEC bids will be submitted by units actually willing and able to provide DEC energy so that the CAISO operators face a significantly lower probability that the units they ask to provide decremental energy are in fact unable to provide it.

### **3. Concluding Comments**

For the reasons described above, we support the CAISO position that the DEC Bidding Rule be suspended at the start of MRTU. Nevertheless, we recommend that the Department of Market Monitoring (DMM) monitor the volume of DEC bidding activity and DEC bid prices to ensure that there are sufficient DEC bids to operate the system in real-time without having to resort to calling on units that did not submit DEC bids. Specifically, we believe that DMM should monitor the frequency and magnitude of the event that units that did not submit DEC bids were required to meet a DEC energy need that arose between the close of the DA IFM and the RT market.