Stakeholder Comments Template

Subject: Convergence Bidding

Pacific Gas & Electric appreciates the opportunity to participate in the convergence bidding stakeholder process and to submit comments regarding the November 14, 2007 CAISO presentation.

1. Does your entity have suggestions or comments on the process by which the CAISO will resolve the nodal versus zonal granularity issue?

PG&E’s position remains unchanged from that outlined in its August 7, 2007 comments to the CAISO. We continue to support a go-slow, incremental approach to convergence bidding with an initial LAP-based implementation. We believe this approach meets the FERC mandate while best protecting our customers from possible market design flaws and manipulation. We agree with the Department of Market Monitoring (DMM) statement that implementing convergence bidding at the LAP level initially would capture many of the potential benefits of convergence bidding, while limiting the potential adverse effects of convergence bidding at a more granular level.¹ In fact, much of November 7, 2007 DMM paper is dedicated to outlining numerous mitigation and monitoring provisions that would be necessary to support nodal convergence bidding.

Moreover, there are practical considerations related to the granularity question. First, it just does not make sense to implement a quantum leap to nodal convergence bidding while the market participants will still be adjusting to the many implications of MRTU-Version 1. Second, an incremental approach allows the CAISO to apply the lessons learned from an initial LAP-based approach to an expanded nodal design. Finally, the CAISO needs to be mindful that stakeholders, like the CAISO, will need to build software and other infrastructure to support convergence bidding. Load-serving-entities like PG&E will be very busy in 2008 and 2009 refining its MRTU-Version 1 software and systems. Of course, this is where our focus should be, but it will limit our ability to take on the seemingly large

undertaking of developing software and infrastructure that can support nodal convergence bidding and settlements for some 3,000 nodes.

2. What are your entity’s views on the proposed characteristics of virtual bids (that were reviewed at the November 14th meeting)?

Overall, PG&E is supportive of the proposed characteristics of convergence bids presented on November 14th with the following exceptions:

(1) We question whether 10 bid segments are necessary for convergence bids and if so many segments creates unnecessary complexity. We would ask the CAISO to check with their eastern ISO counterparts to see how many bid segments were implemented in other markets.

(2) PG&E is withholding judgment on convergence bidding at EZ trading zones. The CAISO indicated they are exploring this possibility and that there may be potential problems with this functionality. The CAISO told stakeholders that additional information would be forthcoming on the details of convergence bidding at EZ trading zones and an examination of any problems. PG&E will provide comments on this issue after the CAISO provides this additional information.

(3) Three of the characteristics seemed primarily geared towards nodal convergence bidding: positions limits, CRR settlement rule, and the uninstructed deviation penalty. In fact, the table on page 16 of the November 2007 DMM paper indicates that these rules are NOT required for a LAP design but are needed for a nodal design. The reason provided by the DMM is that the ability for an individual participant to affect market prices in LAP-level convergence bidding is limited by the relatively large size of LAP market. It seems that decisions regarding these characteristics are premature and decisions on mitigation rules geared towards the nodal design should be made after the primary granularity decision is made.

As stated above, PG&E supports LAP level bidding in the Day Ahead market. If, and when, nodal bidding is adopted, additional market power mitigation measures as described by the DMM will be required. These measures will require new tools, processes and resources as detailed in Attachment A of the November 2007 DMM Report. PG&E will provide more detailed input on the tools needed to support nodal convergence bidding after the CAISO, with stakeholders input, decides that the time is right to implement the nodal approach.

3. What are your entity’s views on proposed changes to the Day Ahead market which are needed to facilitate convergence bidding?

In general, PG&E is supportive of the changes to the Day Ahead market that are being proposed by the CAISO. These changes would be made regardless of the granularity decision.
As demonstrated by the DMM, convergence bids can undermine local market power mitigation. This seems especially true for nodal-level convergence bidding. Because of this, PG&E supports the CAISO’s recommendation to exclude convergence bids in the mitigation runs.

PG&E supports the CAISO’s proposal for the daily publication of the amount of convergence bids that clear the IFM. PG&E suggests that the SC designation associated with the cleared bids also be provided to assist in market transparency.

Although PG&E understands how convergence bid demand may commit fewer RMR units than would be needed, we would like additional detail from the CAISO on the anticipated impact on RMR and the specific process the CAISO would use to identify a RMR shortfall and commitment of additional units. PG&E suggests that the CAISO address this in greater detail at a future stakeholder meeting.

4. What are your entity’s views on the proposed credit policy and processes for virtual bids?

The proposed credit policy and processes appear reasonable. However, we would like to see what the 95th percentile collateral level is (based on data from the first year of MRTU) before implementing that level. It would be instructive to see how that level compares to the NYISO’s flat $200/MWh collateral requirement. As indicated in the DMM November 2007 paper this relatively high level helps to prevent the submissions of convergence bids at extreme prices that have little chance of being accepted.²

5. What are your entity’s views on the CAISO’s proposal (explained at the November 14th meeting) for allocating costs for virtual transactions?

PG&E has several concerns with the cost allocation proposal put forth by the CAISO.

First, PG&E supports the fair allocation of all uplift costs, both day-ahead and real-time, to both physical and convergence bids. The CAISO proposal only addresses the day-ahead costs and omits any real-time uplift allocation.

Second, the netting of the convergence demand and supply bids by SC to determine the convergence bid MWs used in the rate calculation seems arbitrary. The goal of the “netting” as explained by the CAISO is to minimize convergence bid uplift cost to encourage market participation. However, instead of modifying the cost allocation to meet this end, PG&E supports a fair and non-arbitrary set of rules to allocate uplift costs. Moreover, during the presentation Southern California Edison (SCE) stated that FERC in a MISO ruling had rejected the concept of netting demand and supply

convergence bids for cost allocation. This warrants further investigation, and we encourage the CAISO to investigate the implications and scope of this MISO ruling.

Finally, PG&E disagrees with the mechanics of the proposed cost allocation as illustrated by the presentation example. The example results in different effective IFM Tier 1 rates for convergence and physical bids. This difference is an artifact from determining an allocation rate based on one convergence demand value and then applying the resultant rate to a different convergence demand value. The use of one demand value to calculate the rate and then another in the application of the rate does not make sense and artificially reduces the effective allocation rate for convergence bids with no seeming cost allocation rationale.

6. What are your entity’s views on the potential interaction of nodal convergence bidding and Inter-SC Trades?

As stated in our response to question 2, determination of mitigation measures and rules geared towards the nodal design are premature and should be made after the primary granularity decision is made. If, and when, nodal bidding is adopted, additional market power mitigation measures, including provisions to address seller’s choice concerns, will be required. PG&E will provide more detailed input on the measures needed to support nodal convergence bidding after the CAISO, with stakeholders input, decides that the time is right to implement the nodal approach.

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3 The effective rate in the example for the physical bid is $1.32 per MW ($47,442/36,000 MW), whereas the rate for the convergence bid is $0.83 per MW ($2,558/3,100 MW).
4 3,100 MW - which is the summation of the netted values by SC, excluding SCs with net virtual supply.
5 2,000 MW - which is the summation of the system convergence demand less the summation of the system convergence supply.