Stakeholder Comments Template

Subject: Convergence Bidding

As a follow-up to the discussion at the August 10 meeting of the Market Surveillance Committee (MSC), the CAISO is requesting additional written comments on convergence bidding, especially the level of granularity at which virtual bidding should be introduced within the CAISO markets.

A number of parties have already submitted comments on this granularity issue, and those comments will remain posted and part of the record for stakeholder process. This template is offered as a guide for any additional comments that participants may have based on the MSC discussion. Documents related to this meeting are posted at: http://www.caiso.com/1807/1807996f7020.html.

Comments should be submitted in any format by close of business on Friday, August 24, 2007 to: convergencebidding@caiso.com.

The CAISO offers the following questions as a guide for formulating stakeholder comments:

1. Would convergence bidding enhance your organization's business needs. If so, how? What does your entity view as the primary benefits of convergence bidding to the CAISO’s energy markets?

   Yes. Convergence Bidding would definitely enhance our organization’s business needs. Here are some of the benefits we see:

   • Draws in more market participants.

   • Adds to market liquidity.
• Provides an excellent mechanism for the market to discourage certain kinds of inappropriate behavior without resorting to activity rules

• Helps focus attention on price expectations rather than on how to circumvent the rules

• Allows us to hedge certain risks – asset performance, load forecast uncertainty, congestion

• Gives market participants confidence in the prices as a valid reference for indexing contracts and obtaining project financing

• Provides asset-based market participants with incentives to bid and schedule realistically. Eliminates incentives to under-schedule.

2. What are your entity’s views on the level of granularity at which the CAISO should introduce convergence bidding (LAP-level virtual bidding or nodal-level virtual bidding)?

Initial implementation should be at the nodal level because:

• Nodal-level bidding focuses more attention on nodal prices that might otherwise escape close scrutiny as parties focus on LAP-level prices

• Nodal-level bidding is useful for all parties, not just a few large ones. Generators can hedge short-term operating exposures, loads can hedge local load forecast uncertainty, munis and parties that operate at the ties and within a LAP can hedge congestion risks.

• Nodal-level bidding limits opportunities to exercise market power by providing market participants with an incentive to watch nodal prices very closely. Having more eyes on prices helps the DMM more effectively monitor market efficiency, market operations and market participant behavior. Bad actors and price anomalies will be spotted much more quickly than they otherwise might.

• There are no documented market failures associated with Nodal-level convergence bidding. However there are documented problems when
convergence bidding is limited to the LAP (zonal) level\(^1\). The only documented gaming opportunity associated with Nodal-level bidding can be eliminated with a simple settlement rule. Even without this simple rule, any potential gains will be competed away very quickly as other market participants observe a price discrepancy and enter nodal bids of their own to capitalize on it.

3. What are your entity’s views on position limits (limiting virtual bidding to a percentage of the MW volume at each node)?

Strictly speaking, position limits will a) impede the ability of asset-based market participants to hedge, and b) limit the ability of all market participants who engage in convergence bidding to maximize the benefits. For these reasons, they could be counterproductive if set too low.

Imposing position limits will not necessarily have a beneficial impact because an active market will make the only gaming opportunity unprofitable most of the time and a simple, proven settlement rule will make it unprofitable the remainder of the time.

Credit requirements on convergence bidders will limit opportunities for parties to corner the market.

Any consideration of position limits should include explicit schedules for the lifting of the limits.

4. What are your entity’s views on allocating costs to virtual bids?

Cost causation is an acceptable way to determine how certain of the CAISO’s costs are allocated to virtual transactions. However if for example, virtual transactions are to bear certain IFM costs, they should similarly receive credit for cost reduction they bring to the RUC process by leading to less costly commitment decisions in the IFM.


Similarly, since ancillary services are procured based on the CAISO load forecast, virtual bids do not increase the CAISO’s requirement for ancillary service so they don't increase ancillary services costs. Therefore, virtual transactions should not be assessed any ancillary charges.

5. What are your entity’s views about the optimal number of LAPs in California?

There are some advantages to increasing the number of LAPs. However there are several inherent problems with linking more granular Convergence Bidding to an increase in the number of LAPs. First, unless the number of LAPs is expanded to include every node in the network, LAP-level Convergence Bidding does not allow the majority of market participants and the majority of all trading volumes to take advantage of Convergence Bidding. Second, any increase in the number of LAPs will attract intense opposition from politicians who wish to “protect” consumers in LAPs that are likely to have high prices. Third, even if political objections did not materialize, the CAISO would still have to define a whole new series of CRRs that allow market participants to easily hedge congestion risks between this larger set of LAPs, which will take time to work its way through the stakeholder process. Increasing the number of LAPs, unless it leads immediately to one node/one LAP, will take too long, cost too much, create unnecessary distraction, and still fail to address market needs.

Nodal Convergence Bidding should not be tied to the number of LAPs.

Note also: We are members of the Western Power Trading Forum and have prepared in cooperation with other members more detailed granularity comments addressing concerns expressed about granular convergence bidding. For the sake of efficiency we have not repeated those arguments here.