UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket No. ER11-4580-000**

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTION FOR EXPEDITED CONSIDERATION AND OTHER RELIEF OF THE WESTERN POWER TRADING FORUM

I. INTRODUCTION AND SUMMARY OF ANSWER

Pursuant to Rule 213 of the Federal Energy Regulatory Commission's (Commission) Rules of Practice and Procedure,[1] the California Independent System Operator Corporation (ISO) hereby files this Answer to the Motion for Expedited Consideration and other Relief of the Western Power Trading Forum (WPTF) filed on August 29, 2012, in this proceeding. The Commission should find the suspension of intertie convergence bidding as just and reasonable and not unduly discriminatory under the current market design. Otherwise, the Commission should simply dismiss WPTF's motion. The evidence before the Commission fully demonstrates the adverse market outcomes that occurred with intertie convergence bidding under the current market design. Specifically, the ISO demonstrated that intertie convergence bidding under the current market design interfered with day-ahead and real-time price convergence, caused inefficient day-ahead unit commitment, and increased real-time imbalance energy offset (real-time imbalance energy offset) uplifts. After significant opportunity for intervenors to provide evidence demonstrating the alternative, the record still

[1] 18 C.F.R. § 385.213 (2012).

overwhelmingly supports that the suspension of intertie bidding under the current market design is just and reasonable and not unduly discriminatory.

In its motion, WPTF asks the Commission to reinstate intertie virtual bidding under the ISO's current market structure and provides no support for such a determination despite the evidence of adverse market outcomes provided by the ISO.[2] WPTF does not, and cannot, refute the fundamental problems presented by intertie convergence bidding in its motion. To the contrary, WPTF acknowledges certain of these impacts -- conceding that intertie virtual bidding has "contributed to" "uplift" costs in the real-time imbalance energy offset account and "cannot" help to converge hourly Hour-Ahead Scheduling Process (HASP) and five-minute real-time dispatch RTD prices[3] – while simply ignoring the existence of the other negative impacts demonstrated by the ISO. WPTF fails to provide any evidence of market efficiency benefits that justify the imposition of any additional costs to ISO load resulting from intertie virtual bids, even if such costs were to be limited by the measures WPTF alludes to in its motion. The record shows at most, only modest *potential* benefits from intertie virtual bidding under the current market structure. These do not provide sufficient justification for incurring the serious market inefficiencies that the ISO has documented. Finally, as discussed below, the market conditions that gave rise to the ISO's proposal to suspend intertie virtual bidding continue to exist, thus creating an unacceptable risk of large uplifts and inefficiencies if intertie virtual bidding were immediately reinstated. For all of these reasons, the only just and reasonable resolution of the suspension issue is to keep the suspension in place rather than reinstating convergence bidding on the interties.

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2 WPTF Motion at 8.

3 WPTF Motion at 2, 5.

WPTF's alternative proposal – that the ISO be ordered to submit by November 1, 2012, a market structure reform proposal that WPTF fails to describe in its motion – is equally unreasonable and inappropriate. This alternative proposal is unfortunately based upon a series of mischaracterizations of the ISO's stakeholder process and related efforts on this issue over the last eight months. WPTF's motion is also premised on a fundamental misstatement of the reasons for the ISO's preliminary decision to end its current stakeholder proceeding and continue its efforts in the context of a new stakeholder proceeding. Contrary to WPTF's contentions, the ISO has consistently and diligently worked with all stakeholders to find a short-term solution that would enable intertie virtual bidding to be reinstated. However, these efforts have not produced a proposal that would allow for the reinstatement of intertie virtual bidding any sooner than the end of 2013, and not without creating a number of market and reliability issues, which the ISO and stakeholders have not yet been able to resolve. The ISO's proposal – developed with the full involvement of its stakeholders – to fold its ongoing efforts into a new proceeding that will also address compliance with Commission Order No. 764 is a reasonable and appropriate way to proceed.

Accordingly, the Commission should either deny WPTF's motion, or in the alternative issue a final order suspending convergence bidding at the ISO interties until such time the ISO has submitted a new filing under Section 205 of the Federal Power Act to reintroduce intertie virtual bidding with proper measures addressing the issues identified in this proceeding. In the alternative, the Commission should withhold any action in this proceeding until the ISO has had an opportunity to consider broader market design enhancements that also allow for the reintroduction of intertie virtual bidding in a just and reasonable manner.

II. ANSWER

A. The Record Continues to Support Suspending Intertie Virtual Bidding until Corrective Adjustments to the ISO's Market Structure can be Implemented.

The evidence in this proceeding supports the suspension of intertie virtual bidding under the current market design and lends no support for the reinstatement of intertie virtual bidding at this time. Although the ISO will not reiterate here the entirety of evidence currently before the Commission, a summary is appropriate given WPTF's motion. First, in the ISO's initial September 21, 2011, filing requesting the suspension of intertie virtual bidding in this proceeding, Mr. Mark Rothleder testified in detail about the serious negative impacts that intertie virtual bidding had been causing under the ISO's current market structure. His testimony demonstrated that this bidding was interfering with convergence of the day-ahead and real-time markets and was producing large and unwarranted uplift costs in the real-time imbalance energy offset account – costs that are paid for primarily by load-serving entities that have no means to prevent them.[4] Mr. Rothleder explained that this outcome is driven by structural incentives in the existing market structure that create incentives for parties to submit virtual intertie supply and virtual internal demand bids that offset one another. This phenomenon, which occurred both through individual scheduling coordinators submitting balanced schedules and through independent offsetting action by independent scheduling coordinators, drove large increases in real-time imbalance energy offset costs, without providing any increase in market efficiency or price convergence.[5] Mr. Rothleder provided specific data on the divergence of the hour-ahead and real-time prices and provided an estimate

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[4] *See Direct Testimony of Mark A. Rothleder, September 20, 2011, Tariff Amendment Eliminating Convergence Bidding at the Interties, Docket No. ER11-4580-000* ("*Rothleder Testimony*") at pp. 10-16, 20-24.

[5] *Rothleder Testimony* at pp. 15-17.

of the impact of intertie convergence bids on the real-time imbalance energy offset through which these market inefficiencies are played out. Mr. Rothleder concluded that eliminating convergence bidding at the interties is justified at least until a comprehensive market redesign stakeholder initiative allowed the ISO to address issues related to the current design of the hour-ahead scheduling process and real-time market.

The ISO also submitted with its initial filing the Department of Market Monitoring's Quarterly Report on Market Issues and Performance, which further concluded that it was necessary to suspend virtual bidding at the interties in order to mitigate the negative effects that had been observed as a result of such bidding.[6] In particular, DMM noted in its report that as long as there are systematic price differences between the hour-ahead scheduling process and the real-time market, participants can bid in offsetting virtual supply bids on the inter-ties and virtual demand bids on internal nodes. DMM also concluded that this strategy will continue to impose unnecessary costs to the market while providing little or no market or reliability benefits.[7] The ISO also submitted a final opinion of the members of the ISO's Market Surveillance Committee that analyzed and supported the ISO's proposal.

In response to the ISO's filing various parties protested, asking the Commission to deny the ISO's proposal, while other parties supported it.[8] None of the protesting

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6 *See Quarterly Report on Market Issues and Performance Revised August 24, 2011, Prepared by: Department of Market Monitoring*, Attachment E, ER11-4580-000 ("*DMM Report*").

7 *DMM Report* at pp. 22-23.

8 The following parties intervened and have through the stages of the proceeding filed comments in support of the ISO's amendment: Southern California Edison Company; Pacific Gas and Electric; Northern California Power Agency; Cities Of Anaheim, Azusa, Banning, Colton, Pasadena, And Riverside, California; San Diego Gas & Electric Company; California Department of Water Resources; and Powerex. The following parties intervened and have through the stages of this proceeding opposed the ISO's amendment: J.P. Morgan Ventures Energy Corporation; Brookfield Energy Marketing LP; SESCO Enterprises LLC, et. al.; Morgan Stanley Capital Group Inc., DC Energy California, LLC; NRG Companies; Western Power Trading Forum; and Gila River Power, LLC.

parties, however, provided any evidence to contravene the ISO's showing in its initial filing. In response, the Commission accepted the tariff amendment on a provisional basis, while declining to reach a final determination on whether the amendment is just and reasonable. Instead, it ordered a technical conference to further consider the matter and allow parties an opportunity to provide further support for the analysis in their pleadings.[9] Commission staff subsequently established a technical conference which was held on February 2, 2012.

At the technical conference, the ISO provided detailed data and evidence that responded to various questions and concerns raised by the Commission, Staff and intervenors, and that further documented the various market inefficiencies presented by intertie virtual bidding. This evidence was presented in detail by Mr. Rothleder and by Dr. Eric Hildebrandt, Director of the ISO's Department of Market Monitoring.[10] These presentations further demonstrated that intertie virtual bidding negatively impacted price convergence between the day-ahead and real-time markets and had undermined the efficient day-ahead commitment of generating units in the ISO's integrated forward market, thus necessitating greater intervention through the residual unit commitment process.[11] Dr. Hildebrandt also presented the results of market analyses that his department had recently performed, finding that market participants had made little or no use of intertie virtual bidding to facilitate imports of variable renewable resources, to hedge delivery risk on intertie scheduling points, or to hedge congestion, which were the

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9 *Cal. Indep. Sys. Operator Corp*., 137 FERC ¶ 61,157 (2011).

10 *See Technical Conference Discussing CAISO's Proposal to Eliminate Convergence Bidding at Intertie Scheduling Points, Mark Rothleder, Executive Director, Market Analysis & Development, February 2, 2012* ("*Rothleder Presentation*") and *Technical Conference on CAISO's Proposal to Eliminate Convergence Bidding at Intertie Scheduling Points, Eric Hildebrandt, Ph.D., Director, Department of Market Monitoring, February 2, 2012* ("*Hildebrandt Presentation*").

11 *See Rothleder Presentation* at slides 5-6.

principal market benefits that its proponents had alleged.[12] Parties had a full opportunity to question the ISO's presenters and comment on their data. While certain parties expressed disagreement with the ISO's conclusions (and others supported them), no party at the technical conference provided any basis for concluding that the suspension of intertie bidding was unjust, unreasonable, or unduly discriminatory.

At the technical conference, certain parties raised concerns that they did not have access to all of the data from which the ISO's presentations were created and, therefore, were unable to rebut them or provide sufficient data to support their assertions that intertie virtual bidding was providing offsetting benefits. After the conference, the ISO provided the actual market data that parties claimed they needed to make such a showing. In the ISO's post-technical conference comments, the ISO once again demonstrated, based on all of the existing record evidence, the substantial adverse impacts caused by intertie virtual bidding.[13] In contrast, despite the requests by Commission Staff that parties provide specific evidence of the market impacts of eliminating intertie virtual bidding, none of the marketers, WPTF, or generators that protested the ISO filing provided such evidence and no party made use of the data that was provided by the ISO to contravene the ISO's findings.

Therefore, if the Commission were to act now, the only conclusion that it can reach from the evidence before it is that intertie virtual bidding under the current market design produces an unjust and unreasonable aggrandizement of the real-time imbalance energy offset, interferes with convergence of the day-ahead and real-time markets, and

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[12] *See Hildebrandt Presentation* at slides 7-10. Dr. Hildebrandt also presented data from the two months after intertie convergence bidding was suspended showing that, contrary to the protesters' predictions, eliminating intertie virtual bidding did not produce a significant spike in implicit virtual bidding. *See Hildebrandt Presentation* at slides 11-12.

[13] *See Initial Comments of the California Independent System Operator Corporation,* Docket ER11-4580-000, at pp. 4-10 (March 16, 2012) ("*CAISO Initial Comments*").

undermines efficient day-ahead unit commitment. Moreover, the record demonstrates that the impacts of these problems are potentially unbounded because (1) there are no limits to the ability for parties to submit intertie convergence bids that have no demonstrable market benefits but impose additional unwarranted costs, and (2) the parties that bear those costs, *i.e.*, load, have no way to engage in bidding practices that offset the impact or otherwise prevent it. The record also does not support any level at which such costs could theoretically be justified given the lack of record evidence demonstrating a current need for intertie virtual bidding for legitimate hedging purposes.[14]

B. Under Current Market Conditions, Reintroduction of Intertie Virtual Bidding under the Current Market Design would Impose Serious Risk.

WPTF and the ISO seem to agree about the underlying market design issues that drove the ISO to propose suspending intertie virtual bidding.[15] WPTF is correct in stating that "[t]he fundamental problem underlying the proposed need to eliminate intertie virtual bidding is the overlay of the third HASP settlement layered on the CAISO's two-settlement market."[16] The ISO also agrees with WPTF's statement that "[t]his separate HASP price creates an interplay between internal convergence bids (which are

14 *CAISO Initial Comments* at pp.13-14. *See also* Reply Comments of the California Independent System Operator Corporation and the Department Of Market Monitoring, Docket No. ER11-4580 (March 30, 2012). In its motion, WPTF suggests that concerns about negative impacts of intertie virtual bidding could be addressed by including the potential "protections" that WPTF proposed in its post-technical conference comments. See WPTF motion at 8 & fn. 17. The "protection" that WPTF proposed was a "circuit breaker" that would suspend intertie virtual bidding only if the amount of real-time imbalance energy offset uplift for a month exceeded $3.5 million and would stop the bidding only for the remainder of the month, allowing it to recommence in the next month. This "protection" is largely meaningless. It would mean that approximately $40 million in annual uplift would be allowed as a matter of course, along with all of the related inefficiencies that the ISO has identified. WPTF has presented no evidence, nor has any other party, to justify imposing such inefficiencies on the ISO's markets.

15 WPTF Motion at pp. 5-7.

16 *Id.*, at 5.

established at Day-Ahead prices and liquidated at [RTD] prices) and intertie convergence bids (which are established at Day-Ahead prices and liquidated at HASP prices) that does not – and in fact, cannot – converge HASP and [RTD] prices." WPTF further correctly notes that "this interaction creates additional transaction volumes outside of the [RTD] that settle at [RTD] prices, and thereby increases the real-time imbalance energy offset." The ISO also agrees with WPTF that "[t]he high cost of real-time imbalance energy offset cost is not solely associated with the HASP settlement and intertie convergence bidding" and that real-time imbalance energy offset costs "remain substantial following the elimination of intertie convergence bidding."[17]

WPTF fails, however, to come to grips with the import of these facts and their implications if intertie virtual bidding were to be reinstated under the current market design. As demonstrated by the ISO in Mr. Rothleder's testimony and in the ISO's post-technical conference comments, a divergence of the HASP intertie price and the RTD price makes the bidding strategy of combined virtual supply intertie bids and virtual internal load bids lucrative and attractive, whether pursued by a single scheduling coordinator or by various scheduling coordinators acting independently.[18] Thus, the fundamental structure of the market creates a serious risk of inefficiency whenever such divergence otherwise exists.

WPTF fails to provide any analysis or evidence to contravene the ISO's prior demonstration that this divergence is precisely what incents parties to engage in a bidding strategy that aggravates the already expanding real-time imbalance energy offset.[19] With intertie virtual bidding in place, any price divergence between hour-ahead

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17 *Id*., at pp. 5-6.

18 *Rothleder Testimony* at pp. 21-23; *Rothleder Presentation* at slides 11-13.

19 *Rothleder Testimony* at pp. 10-12; *Rothleder Presentation* at slide 5.

and real-time will drive the real-time imbalance energy offset up through potentially large volumes of offsetting virtual import and virtual internal demand, as described above and at greater lengths in the ISO initial filing and subsequent pleadings in this proceeding.

Therefore, given no change in the current market design and the continued divergence of hour-ahead and real-time prices, the only just and reasonable option, if the Commission decides to now reach a final determination, is to suspend intertie virtual bidding until such time the ISO is able to make a new filing demonstrating that the issues identified in this proceeding are addressed.

C. WPTF's Alternative Proposal that the Commission Order the ISO to Submit an Unspecified Proposal by November 1, 2012 is Meritless and Improper.

On July 27, 2012, after more than a year working diligently with stakeholders to identify and evaluate proposals for near-term market structure changes to allow for the reintroduction of intertie virtual bidding, the ISO informed stakeholders that it had concluded that the various options identified and considered would not improve overall market efficiency and instead introduced counterproductive complexity and operational risks.[20] In light of this conclusion the ISO has discontinued its effort to establish a narrowly scoped shorter-term solution and instead will further address these issues in the context of a new stakeholder initiative that will also address compliance with the Commission's Order No. 764. In its notice, and in a follow-up meeting with stakeholders, the ISO explained that this new stakeholder initiative, which it intends to initiate next month, "will allow the ISO and stakeholders to develop real-time enhancements that

[20] *See* July 27, 2012 Market Notice in the Intertie Pricing and Settlement Initiative, WPTF Motion, Attachment A ("*Market Notice*").

provide a superior structural framework for re-introducing convergence bidding on the [inter]ties."[21]

In an effort to convince the Commission to compel the ISO to take action to quickly reintroduce intertie virtual bidding, WPTF mischaracterizes the record of the ISO's intertie pricing stakeholder proceeding and seeks to create the false impression that the ISO is unreasonably withholding a workable near-term solution that would permit intertie virtual bidding to be reintroduced. This mischaracterization takes several forms.

First, WPTF incorrectly suggests that the ISO has developed a proposal that is nearly complete and that would allow the ISO to reintroduce virtual convergence bidding without serious inefficiencies or negative impacts. This is not the case. As the ISO made clear in the first two sentences of its July 27, 2012 market notice – sentences that WPTF avoided mentioning in its motion – the fundamental reason why the ISO is not moving forward with a proposal to reintroduce intertie virtual bidding at this time is because the various options that have been identified and considered do not improve overall market efficiency and pose other serious problems. Specifically, the ISO explained that:

> Fundamentally, after over a year of careful consideration, none of the options that have been proposed for reintroducing convergence bidding at the interties appear to improve overall market efficiency. At the same time, many of the options considered create additional complexities for the market and operations and introduce new market and operational risks.[22]

WPTF does not even mention, let alone attempt to refute, this fundamental conclusion. Moreover, WPTF's complete failure to identify or discuss even the broad outlines of the unspecified proposal that it would have the Commission command the ISO to produce

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[21] *See Id.*; *see also Settlements of Interties in Real-Time, Karl Meeusen, Ph.D., Market Design and Regulatory Policy Lead August 7, 2012*. http://www.caiso.com/Documents/Presentation-IntertiePricingSettlementAug7_2012.pdf.

[22] *See Market Notice.*

reflects the simple fact that the ISO and stakeholders have not been able to develop a near-term proposal that can be implemented without creating potentially serious market inefficiencies, operational problems, or both.[23]

This outcome was, moreover, not for lack of effort. Over the period of November 2011 through July 2012, the ISO undertook an extensive working group and stakeholder process that included development of an issue paper followed by multiple working group meetings, the development of array of potential measures to address the issues that were then vetted and presented in a series of draft straw proposals, numerous stakeholder meetings to receive input and comment on the various proposals, written comment periods for each straw proposal iteration, and careful evaluation of the varying comments and proposals made by the parties, including WPTF.[24] The ISO devoted many hundreds of hours of senior ISO staff member time to the consideration and development of potential proposals. If this process had produced a proposal to reintroduce intertie virtual bidding that was workable, efficient, and without serious operational risks, the ISO would have moved forward to propose it.

Second, WPTF attempts to create an impression that the ISO acted arbitrarily and without appropriate stakeholder input by characterizing the ISO's decision as "authoritarian" and "unilateral."[25] The lengthy and extensive stakeholder process discussed above belies this characterization. Moreover, the July 27 Notice was not dropped on stakeholders unexpectedly without their input, as suggested by WPTF.

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[23] *See* Comments submitted by stakeholders to the ISO's latest straw proposal: http://www.caiso.com/Documents/Intertie%20pricing%20and%20settlement%20stakeholder%20comments%7CComments%20on%20third%20revised%20straw%20proposal. The majority of stakeholders, including WPTF, have raised concerns regarding the ISO's latest proposal.

[24] *See* stakeholder initiative webpage: http://www.caiso.com/informed/Pages/StakeholderProcesses/IntertiePricing_Settlement.aspx.

[25] WPTF Motion at 2, 8.

Having been unable to identify a pricing solution that could be implemented without causing other market inefficiencies or reliability concerns, the ISO initiated a dialogue with its stakeholders to consider the inevitable interplay between Order No. 764 and its current stakeholder initiatives. Specifically, on June 29, 2012, one week after the Commission issued Order No. 764, the ISO posted a stakeholder template for comments to the ISO's latest straw proposal in the intertie pricing stakeholder process. The very first question in the template was:

> On June 22, 2012, FERC issued its "VERs Order," instructing the ISO to implement 15 minute intertie schedules. Given this order, and its relationship to the current stakeholder initiative, does your organization believe this ruling will or should have material impacts on the issues addressed and the ISO's proposed schedule? If so, what is the most appropriate next step in this stakeholder initiative?[26]

Although some parties' comments (including WPTF's) supported continuation of the current proceeding without any modification, others supported the course of action that the ISO ultimately decided to undertake.[27] In any event, the ISO clearly provided a full and fair opportunity for parties to be heard and did not act without proper stakeholder input.

Third, in an effort to create the misimpression that the ISO's motives are improper or its conclusion ill-considered, WPTF misstates the ISO's contentions regarding the interplay between Order No. 764 and the intertie pricing and convergence

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[26] *See Stakeholder Comments Template, Settlement of Interties in Real-Time Third Revised Straw Proposal, June 20, 2012*, available at: http://www.caiso.com/Documents/CommentsTemplate-Intertie%20PricingSettlementThirdRevisedStrawProposal.doc.

[27] See Comments Pacific Gas and Electric, Southern California Edison, and Powerex supporting the ISO's decision (http://www.caiso.com/Documents/Comments%20on%20Aug%207,%202012%20stakeholder%20call and http://www.caiso.com/Documents/Intertie%20pricing%20and%20settlement%20stakeholder%20comments%7CComments%20on%20third%20revised%20straw%20proposal). WPTF chose to limit its comments to the following two concluding sentences without any explanation for its position: "No. We expect the intertie proposal should go forth."

bidding issues. Contrary to WPTF's assertions, the ISO did not in any way state or suggest that it is pursuing the consolidation of these efforts because Order No. 764 "required" this to occur. As evidenced by the ISO's market notice itself, the ISO simply identified the obvious interplay between the Commission's mandate to make fifteen minute scheduling available and intertie pricing. The ISO and other parties, including WPTF in its own motion, have described in great detail how the separation of the scheduling and pricing processes between the hourly HASP for external resources and the five-minute RTD for internal resources has led to certain market inefficiencies. While the ISO understands that the Order No. 764 does not require a change in settlement of the interties but only requires that the ISO consider whether it must adopt additional intertie scheduling flexibilities,[28] it is reasonable for the ISO and stakeholders to consider together in one stakeholder proceeding both how the ISO can meet the Commission's Order No. 764 requirements and how it can best address issues involving the dispatch and settlement of the interties relative to the dispatch and settlement of internal resources. Given its involvement in the stakeholder process designed primarily to address the intertie pricing and settlement issues posed by the current market design, it is disingenuous for WPTF to suggest that the ISO's consideration of the resolution of its intertie pricing issues in the context of Order No. 764 is unfounded and without merit.

While the order does not require settlement changes, the ISO's experience with a market design that does not adequately address the interplay of a pre-scheduling process and real-time market is instructive on the need to do so when considering any scheduling timelines. The Commission's requirement of a compliance filing that enables the implementation of 15-minute or better scheduling within 12 months of the effective date of the order requires that ISO staff immediately turn its attention to this effort.

[28] *See e.g.*, *Integration of Variable Energy Resources*, 139 FERC ¶ 61,246 at P 113 (2012).

WPTF suggests that the ISO should not be concerned with this because it seems to believe that it is unlikely for the West to move towards more granular scheduling regimes in the near future, despite the Commission's mandate in Order No. 764.[29] WPTF's suggestion that the ISO not plan for such changes seems to be contrary to the spirit of the Commission's order and counter-productive at such crucial cross roads when all Western entities are working together to find solutions to these collective issues.

The ISO has been working with its stakeholders and neighbors since 2010 in various stakeholder efforts to identify and formulate necessary market rule changes that enable variable energy resources to participate more efficiently in the ISO markets.[30] The ISO has made significant efforts towards providing variable energy resources in and out of the ISO system to participate in the ISO market more economically so that the ISO can manage their participation. In some cases, such as in the development of more flexible dynamic scheduling rules, the ISO's efforts were specifically targeted towards better management of external variable energy resources entering and exiting the ISO systems.

Order No. 764 further justifies the ISO's investment in more robust market design changes that previously had been less justifiable in light of constraints forced by external systems, including the fact that the bulk of the Western grid has been operated on the basis of hourly schedules. With the prospect of greater flexibility from external entities as a result of the Commission's efforts in Order No. 764, it is the ISO's goal to not only meet the minimum requirements of Order No. 764, but to explore whatever system changes may be necessary to prepare the ISO system for the inevitable future system

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[29] WPTF Motion at 6.

[30] *See e.g.*, ISO stakeholder initiative page: *http://www.caiso.com/informed/Pages/StakeholderProcesses/IntegrationRenewableResources.aspx.*

needs as greater variable energy resources penetrate the ISO and other systems in the West.

The market elements that create the inflexibilities for the integration of variable energy resources – the duality of the hour-ahead process and real-time market – are the same market elements that the ISO is required to address in connection with potentially reintroducing intertie virtual bidding.[31] WPTF itself states that "[t]he only sensible and durable way to deal with the real-time imbalance energy offset is to eliminate the HASP settlement or to implement a true three-settlement system through a full hour-ahead market." While it is not clear at this time precisely what market rule changes will best enable the reintroduction of intertie virtual bidding, the ISO now believes that it is most reasonable to concentrate its efforts and the efforts of its stakeholders towards resolving that issue in the context of the greater market design issues the ISO will be considering in light of Order No. 764. The ISO anticipates that its stakeholder effort addressing the Order No. 764 changes could likely include replacing the current HASP energy dispatch with a 15-minute dispatch that dispatches interties and internal resources at the same time and settles them at the same price. Although there would likely still also be a separate shorter duration dispatch for internal and dynamically scheduled intertie resources, dispatching both interties and a substantial portion of internal generation at the same time and settling them at the same price would significantly address the real-time imbalance energy offset issues in the current market.

Fourth, the ISO cannot ignore the overlap in the timing during which the ISO must address the Order No. 764 compliance issues and the market issues presented by the current intertie pricing design. Even the latest proposal considered in the ISO's

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31 *See e.g.*, *Renewables Integration Market Vision & Roadmap Revised Straw Proposal,* 8/29/2011 (http://www.caiso.com/Documents/RevisedStrawProposal-RenewablesIntegrationMarketandProductReviewPhase2.pdf).

intertie pricing stakeholder process could not be implemented under the best of circumstances until the end of 2013.[32] That proposal was found by ISO management to provide more risks than benefits and, therefore, not a a viable option given the current real-time market structure. Given the severity of the issues still present, the process of seeking resolution of those issues is itself likely to take several more months and would require the ISO to conduct two concurrent stakeholder processes that seek to modify the same aspects of the ISO market but potentially in completely different ways. Indeed, it could lead to the undesirable situation in which the ISO and stakeholders would be working to resolve the issues that plague the latest proposal considered, while at the same time considering market enhancements which would potentially eliminate the need for such changes in the first place. Given the lack of evidence for the immediate need for intertie virtual bids and the overwhelming evidence of market inefficiencies brought to the market by their presence, WPTF has provided no justifiable reason to engage in such a futile endeavor.

Finally, WPTF incorrectly suggests that the ISO somehow failed to meet a commitment to its board to work on developing market structure changes that would enable reintroduction of intertie virtual bidding. In its February Board of Governors meeting, ISO staff committed to its board to work towards developing market solutions that would allow for the reintroduction of intertie virtual bidding. The ISO set off to do exactly that and, in pursuit of this objective, mobilized considerable staff and stakeholder effort designed to address the intertie pricing issues that also contributed to the issues raised by intertie virtual bidding. The ISO did not commit, however -- either to its board or to the Commission – to simply implement whatever parties may come up with in order

[32] *See Settlement of Interties in Real-Time Third Revised Straw Proposal, June 20, 2012,* p. 3 (http://www.caiso.com/Documents/ThirdRevisedStrawProposal-IntertiePricingSettlement.pdf).

to quickly reintroduce intertie virtual bidding irrespective of any identified negative impacts. Because the ISO and the parties have been unable to identify a comprehensive, readily implementable solution, and in light of the issuance of the Commission's order directly impacting intertie scheduling, the ISO feels it is both reasonable and prudent to report to its board the state of the current stakeholder process and its intent to pursue a more comprehensive market design solution in light of the prospect of more granular scheduling at its interties next year.

The ISO also has not failed to keep the board or the Commission apprised of its decision. All of the ISO's proposals in this area have been publicly posted on the ISO's stakeholder website, and the ISO's consideration of these issues has been open and transparent. Moreover, the ISO is currently scheduled to report on this issue at the board's scheduled meeting on September 13, 2012 and had intended to formally inform the Commission of its conclusions after briefing and receiving any guidance from its board. WPTF's motion appears to be a premature attempt to interfere with that process and convince the Commission to take precipitous action.

Given that WPTF has submitted this motion to the Commission to act now in this proceeding, the ISO is compelled to ask the Commission to do the only reasonable thing at this time given the facts before it. If the Commission acts now to answer the question of whether the suspension of intertie virtual bidding is just and reasonable at this time, the Commission must find that it is. At this juncture, the ISO believes that the best opportunity for the reintroduction of intertie virtual bidding is in the context of market design changes that adequately address the intertie pricing issues. Given the challenges in achieving such solutions, the ISO urges the Commission to allow the current process to proceed consistent with the timeframes needed to address the market rules impact of the Order No. 764 changes.

III. CONCLUSION

For all the reasons stated above, and the numerous filings and pleadings filed by the ISO in this proceeding, the ISO asks that if the Commission acts on the record now, it find that the suspension of intertie virtual bidding at this time is just and reasonable and not unduly discriminatory. The Commission should otherwise dismiss WPTF's motion.

Respectfully submitted,

By: *<u>/s/ Anna A. McKenna</u>*

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Dated: September 13, 2012

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service list for the above-referenced proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 13th day of September, 2012.

/s/ Anna Pascuzzo

Anna Pascuzzo