Straw Proposal
E-tag Timing Requirements Initiative

December 7, 2009
Straw Proposal

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1 Executive Summary

During the Convergence Bidding stakeholder process, the ISO committed to undertake a stakeholder process to consider new e-tagging requirements or some other mechanism to ensure that the ISO can effectively differentiate between physical and financial (implicit or explicit virtual) bids on the interties.

This straw proposal determines if a bid is physical or financial on the interties not by ensuring a physical schedule is truly physical, but by ensuring that an implicit virtual bidding strategy would be less economic than implementing a purely financial strategy through convergence bidding. The straw proposal recommends the following modifications:

1. Increased charges and removal of the exemption threshold for ISO tariff Section 11.31 HASP Intertie Schedule Charges
2. Apply the CRR Settlement Rule to day ahead awards which are 100% reversed in the Hour Ahead Scheduling Process (HASP).

The straw proposal does not change to the existing ISO e-tag timing requirements. In addition, the straw proposal documents that Grid Management Charges (GMC) are lower for convergence bidding than for implicit virtual bidding.

2 Introduction

ISO market participants have identified e-tag timing requirements as an area potentially in need of revision, particularly with respect to the e-tagging of energy interchange schedules awarded in the ISO’s day-ahead integrated forward market (IFM). The ISO currently subscribes to WECC Business Practice Standards, WECC (ISAS) Pre-scheduling conventions and NERC Reliability Standards related to e-tag processing and timing. However, the only applicable compliance requirement is the NERC reliability requirement, contained within NERC INT-008, which stipulates that e-tags are late if not submitted by the Purchasing Selling Entity at least 10 minutes prior to the hourly ramp, or 20 minutes prior to the start of the operating hour (“T-20” minutes) for the WECC.

The purpose of the e-tag timing requirements initiative is to evaluate the ISO’s current e-tag timeline and associated monitoring and compliance procedures to assess whether any modifications are warranted and if so, to propose modifications in a manner that supports both the ISO market functions as well as the requirements of prudent and reliable grid operations.

3 Plan for Stakeholder Engagement

<table>
<thead>
<tr>
<th>Item</th>
<th>Date</th>
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<tbody>
<tr>
<td>Post Straw Proposal</td>
<td>December 7, 2009</td>
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<tr>
<td>Stakeholder Conference Call</td>
<td>December 14, 2009</td>
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<td>Stakeholder Comments Due</td>
<td>December 21, 2009</td>
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<tr>
<td>Stakeholder Conference Call</td>
<td>January 14, 2010</td>
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<td>Stakeholder Comments Due</td>
<td>January 21, 2010</td>
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<td>Board Meeting</td>
<td>February 11, 2010</td>
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4 Background

Certain market participants have expressed concern that the ISO’s current e-tag timeline may result in reduced reliability and unintended market impacts. For example, their assertion is that day-ahead import schedules for which energy and transmission are not procured in the day-ahead timeframe and are not substantiated by submission of day-ahead e-tags may not provide the ISO the same certainty regarding the real-time delivery of the imports as those for which day-ahead e-tags are submitted. In other words, when a market participant waits until after the HASP to procure the energy and transmission and submit an e-tag to physically schedule the interchange, the ISO market essentially receives an hour-ahead product for an award that was cleared in the day-ahead market and paid the day-ahead price.

Some market participants have also argued that only requiring submission of Requests for Interchange (RFI’s or e-tags) after HASP allows parties to engage in “implicit virtual bidding” at the interties, i.e., day-ahead interchange transactions which the market participant intends to liquidate in the HASP rather than deliver in real time and that are not backed by actual physical resources. This type of activity could have reliability impacts to the extent a schedule clears the HASP clears but is not delivered in real time.

Market participants have also argued that under convergence bidding, which the ISO intends to implement by February 1, 2011, without additional tagging requirements market participants may have incentives to provide “implicit virtual bids” to avoid market costs and rules such as the Congestion Revenue Rights (CRR) claw back rules, certain Grid Management Charges (GMC), and the convergence bidding IFM and RUC Tier 1 uplift cost allocation. When convergence bidding is implemented it will be important to guard against “implicit virtual bidding” so that the ISO can accurately differentiate between physical schedules and virtual schedules over the interties.

The NERC e-tag timing requirement, which is the only requirement that has associated compliance provisions, is currently 20 minutes before the start of the operating hours or T-20. However, it is common business practice within WECC for the vast majority of market participants to e-tag their day-ahead awards the day before actual delivery, in the WECC Pre-Scheduling timeframe. A survey of ISO schedulers estimates that 95 percent of day-ahead schedules are e-tagged within this WECC Pre-scheduling timeline. If changes are made to a scheduling coordinator’s day-ahead schedule in the HASP, the scheduling coordinator then adjusts its e-tag to reflect the HASP quantity prior to the T-20 NERC deadline.

ISO Operating Procedure S-313 outlines the e-tag submission timeline. Purchasing Selling Entities, on behalf of their respective ISO market participants, must follow the e-tag submission timelines shown below, in accordance with WECC business practice standard:

<table>
<thead>
<tr>
<th>Step</th>
<th>PSE Actions</th>
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<tbody>
<tr>
<td>1</td>
<td>Submit Tag on time to comply with NERC timetables and policies.</td>
</tr>
<tr>
<td>2</td>
<td>Submit Pre-Schedule Tags by 1500 Pacific Prevailing Time on the Day Prior to the start of the transaction.</td>
</tr>
<tr>
<td>3</td>
<td>Submit Real-Time Tags by 20 minutes prior to the start of the transaction.</td>
</tr>
<tr>
<td>4</td>
<td>Submit Tags or adjustments to tags as soon as possible after the transaction is awarded in the Day-Ahead, HASP or Real-Time Markets.</td>
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NERC Standard INT-008-3\(^1\) outlines the e-tag submission timeline for the Interchange Authority while INT-006-3\(^2\) outlines the e-tag response timeline for the Balancing Authority and Transmission Service Provider. The two standards ensure that each e-tag is checked for reliability before it is implemented. An e-tag submitted to an Interchange Authority after T-20 (10 minutes + 10 minute ramp) is deemed late by NERC for market participants within WECC.

Current WECC business practice standard INT-BPS-003-0\(^3\) requires e-tags to be submitted for preschedules at 1500 PPT on or before the day the interchange preschedule is submitted. Each Balancing Authority, Transmission Service Provider and Purchasing-Selling Entities shall produce evidence that the timing requirement was met. Compliance monitoring is the responsibility of the WECC entity as designated by the WECC Board of Directors. Currently there are no levels of non-compliance outlining sanctions which may occur for repeatedly late e-tags.

There also may be potential unintended consequences that result from strict enforcement of earlier e-tag requirements. An earlier requirement may reduce day-ahead market liquidity by reducing the time market participants have to secure energy and transmission to meet their day-ahead awards. Additionally, an earlier e-tag timing requirement may conflict with the timing of when transmission routinely becomes available in other balancing authority areas. In considering whether it is appropriate to implement earlier e-tagging requirements in the ISO’s markets, it is important to assess the potential adverse impacts as well as the benefits.

5 Proposal

5.1 Summary

The ISO appreciates the many detailed comments received from stakeholders in regards to the issue paper. The proposal below seeks to ensure that the incentives, penalties and costs provide the appropriate economic signals to market participants that discourage implicit virtual bidding and help to ensure that market participants will select convergence bidding for purely financial trades on the interties once it is implemented in 2011. Any day ahead intertie award which has not selected the convergence bidding flag will be assumed to be physical.

Assuming costs were equivalent between physical and virtual awards, it should be recognized that a market participant intending to perform a purely financial trade could utilize a physical schedule. Thus the fact that the award has the attributes of a physical schedule does not prevent a market participant from engaging in implicit virtual bidding. In addition, there are valid economic justifications for reversing day ahead awards in HASP. The proposal below seeks to balance allowing appropriate HASP reversals while closing potential incentives to perform implicit virtual bidding.

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Thus we address issues raised about implicit virtual bidding under the current market structure as well as issues identified in the convergence bidding stakeholder process in regards to determining if an intertie bid is physical or virtual. The issue is not resolved by ensuring a physical schedule is truly physical, but by ensuring that an implicit virtual bidding strategy would be less economic than implementing the financial strategy through convergence bidding.

5.2 E-Tag Timing Requirements

The ISO recommends no change to the current e-tag timing requirement of 20 minutes before the start of the operating hours or T-20. This aligns with the NERC e-tag timing requirement which is the only requirement that has associated compliance provisions.

5.3 HASP Intertie Schedules Decline Charges

Section 11.31 HASP Intertie Schedules Decline Charges apply to any energy import or export when the schedule is not delivered for any reason. The current charge is the MWh quantity of the import or export not delivered multiplied by the greater of $10/MWh or fifty percent (50%) of the HASP intertie LMP. The charge is applied to the quantity of MWhs that exceed the applicable exemption threshold during the trading month. As part of this initiative, the ISO seeks stakeholder comment on whether to eliminate or reduce the exemption threshold and increase the decline charge floor price and the percentage of the HASP intertie LMP. The reduction in the exemption threshold and the increase in decline charges is designed to deter implicit virtual bidding under the current design structure as well as after convergence bidding is implemented in February 2011.

5.4 CRR Settlement Rule Applied to Intertie HASP Reversals

During the convergence bidding stakeholder process, a congestion revenue rights (CRR) settlement rule was developed to help deter the potential use of convergence bidding to increase CRR payments. The rule is outlined in Attachment B to the Convergence Bidding Final Proposal and can be found at http://www.caiso.com/243b/243beb92187a0.pdf. A day ahead intertie award 100% reversed in HASP by a market participant will be considered a virtual bid and subject to the provisions of the CRR settlement rule for virtual bids. By applying the same rule to implicit virtual bidding and convergence bidding, the ISO is removing this potential incentive not to select the convergence bidding flag in the day ahead market.

5.5 GMC Rate Charges Physical vs. Convergence Bidding

The GMC rate structure results in lower transaction costs for purely financial trades to utilize convergence bidding. The Settlements, Metering, and Client Relations charge is equivalent between physical and convergence bidding. Forward scheduling costs are equivalent between physical and convergence bidding in the day ahead market; however, the billing rates differ as convergence bidding utilizes gross cleared MW as the billing determinant. Also, an additional forward scheduling charge will be applied to the HASP reversal. The market usage forward energy costs, applicable to day ahead energy transactions, will be slightly lower for convergence bidding as the convergence bidding bid segment transaction fee offsets costs applied to market usage forward energy applied to convergence bidding which lowers the billing rate. Finally, if a day ahead award is reversed in HASP, the market usage charge (currently $0.4272 per MWh), applicable to HASP transactions, will be incurred. For convergence bidding, since the transaction is automatically reversed, no market usage charge is incurred. As a result, there is a higher transaction cost for implicit virtual bidding than utilizing convergence bidding.
6 Next Steps

The ISO will hold a stakeholder teleconference on December 14, 2009 to discuss the proposal presented in this Straw Proposal. Stakeholders should submit written comments by December 21, 2009 to etagting@caiso.com