Comments on Market Initiatives Stakeholder Meeting
Williams Power Company
July 28, 2006

Williams offers the following comments as requested in the July 24 Market Notice:

Market Initiatives Ranking Process

The CAISO's goal of implementing a consistent, rational process to prioritize among various modifications to its markets is laudable. The straw process proposed by the CAISO, however, is unworkably complex. Developing twelve separate ranking criteria – plus twelve separate weighting factors – is unnecessarily complex. Instead, the CAISO should adopt a methodology using five ranking criteria, each criterion with a scale of one to five. Those criteria should be:

- Improved market efficiency
- Improved market price signals
- Mitigating risk (for CAISO and market participants)
- Improved transparency
- Improved reliability

We are skeptical of quantifying the benefits of market modification in monetary terms. If the CAISO accepts the premise that facilitating competition will itself ultimately bring about benefits to consumers, the CAISO should champion modifications intended to promote competition, not those purportedly designed to achieve savings carved from a foundation of questionable assumptions.

Further, as the CAISO itself noted in the July 18-19 meeting, in many cases the most valuable information that is conveyed by the process of assigning a value to a ranking criterion is the rationale for the value, not the value itself. This information, not mere quantification of ranking criteria, is what market participants, policy makers and regulators will use to make their decisions.

Methodology for Ranking

The proposed first cut "high level" ranking process is important, as the CAISO ostensibly will use the results of this high level process to identify which projects it should gather more information on to inform a more detailed evaluation and ranking process. This "high level" process will lack critical information, namely, the cost of and time needed to implement the project in the CAISO's systems. Without this key information, market participants will be making this "high level" ranking solely on the basis of how much they value particular projects. This may render the high level ranking a very inefficient process, as market participants have been recently surprised to learn that changes they rationally assumed would be relatively easy to implement – such as adding functionality, like convergence bidding, that has already successfully been deployed in other ISOs, or using bid-in demand rather than forecast demand in the LMPM application – require, by the CAISO's evaluation, significant, time-consuming modifications to market systems purportedly designed to facilitate the implementation of new functionality.

Given, then, the likely inefficiency of this "high level" process, the process should:

1. Identify, for each market participant, a relatively small number (up to five) of desired projects. Again, because this method will not produce optimal results if it is later determined that there are projects that might be less valuable but that can be implemented more inexpensively and quickly than other projects, the CAISO must also…
2. Provide an opportunity for market participants to change their rankings as more information about the cost and implementability of projects is provided.

Ranking Criteria

See above.

Other Desired Market Functionality

None at this time.

Convergence Bidding

While our position remains that the Federal Energy Regulatory Commission must direct the CAISO to include this critical market function in Release 1 to ensure a more balanced, market-driven design, we offer the following comments in the event FERC does not take that action.

We expect the CAISO to abide the commitment it made in its March 2, 2006 memo to its Board of Governors to implement Convergence Bidding in Release 1A:

> The first step, referred to as "Release 1A," is targeted for implementation as soon as practical after Release 1, and includes Convergence Bidding as the main new functionality.

At times during the July 18-19 meeting, the CAISO appeared to refer to Convergence Bidding as just one post-Release 1 project that also had to undergo a ranking process along with all other post-Release 1 projects. Such an approach does not comport with the position stated by the CAISO in the March 2, 2006 memo.

In regards to the elements of convergence bidding:

1. Explicit vs. implicit virtual bidding. Convergence/virtual bidding must be explicit for all market participants.
2. Spatial Granularity. NYISO's problem with price divergence between local areas and hubs strongly suggests that the more granular the application of convergence bidding, the more effective convergence bidding is. From a practical standpoint, we do not understand the implications of implementing convergence bidding on a nodal basis when load is proposed to be bid on a LAP basis; perhaps the CAISO can describe how this would occur.
3. Market Power Mitigation. We support implementing the same mitigation as implemented in other ISOs with regard to convergence bidding, i.e., virtual bids are subject to the price caps but no other market power mitigation. Further, the CAISO should take steps to ensure that virtual bids are used for the purpose for which they are intended – to address price differences between markets – and not for any other purpose.
4. Collateral requirements. We see no reason to implement a more constraining collateral requirement, then move to a less stringent collateral requirement, simply because that was the experience of the other ISOs, than to move directly to the requirements that are implemented at the other ISOs. Further, we support using the 50^{th} percentile as the proxy clearing price for the collateral calculation.
5. Allocation of uplift costs. We disagree with the premise that virtual demand bids should always be allocated IFM commitment costs. Virtual demand bids should be allocated IFM commitment costs only if and to the extent those virtual bids increase IFM commitment beyond what would have been committed in the IFM if demand had been accurately bid into the IFM. It makes no sense to allocate IFM commitment costs to virtual demand when physical demand is under-scheduled. In that case, virtual demand is acting to counteract the distorting effects of under-scheduling. To create the maximum

incentive for physical demand to schedule accurately, such commitment costs should be allocated only to physical demand. Conversely, virtual supply should be allocated RUC commitment costs only to the extent that virtual supply reduced day-ahead commitment below that which would have occurred if physical demand had been accurately scheduled.

Because virtual bids will be participating in the DA market, it may seem reasonable to allocate some general uplift costs not associated with unit commitment to virtual bids. (Our position on unit commitment cost is expressed in the previous paragraph.) Before merely spreading uplift costs to all parties participating in its markets, the CAISO should determine why the costs are being incurred and must first allocate such costs according to cost causation principles to the maximum extent possible, recognizing the purpose and nature of virtual bids. Merely participating in CAISO markets should not expose participants to uplift costs if those costs are better allocated to the parties that are causing them. Finally, the CAISO must realize that laying on uplift costs to virtual bids will discourage participation in this market, to the detriment of the real benefits that virtual bidding will bring the markets.

6. LDFs. Given that virtual bidding is a financial tool only, the CAISO should use the same DA LDFs to liquidate the virtual positions in the real time market as it applied to distribute the virtual position in the DA market. Using different DA and RT LDFs will only create uncertainty that will discourage participation in the virtual market.

Multiple Scheduling Coordinators at a Single Meter

No comments.