Stakeholder Comments Template

Subject: Convergence Bidding

As a follow-up to the discussion at the November 14 stakeholder meeting, the CAISO is requesting additional written comments on convergence bidding.

This template is offered as an easy guide for entities to submit comments; however, any participant should feel free to submit comments in any format. Submitted comments will remain posted and part of the record for this stakeholder process, unless participants expressly ask that their comments not be posted.

All documents related to this convergence bidding stakeholder process are posted at: http://www.caiso.com/1807/1807996f7020.html

Stakeholder comments should be submitted by close of business on Friday, November 30, 2007 to: convergencebidding@caiso.com.

The CAISO offers the following topics as a structure for stakeholder comments:

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

   WPTF understands the political sensitivity around this issue and the concerns voiced by some stakeholders that convergence bidding not prove detrimental to Californians. However, this is a clear case, supported by evidence from the four eastern RTOs where convergence bidding has been implemented, that consumers are helped rather than harmed. With one known, well-documented exception\(^1\), we are not aware of any instances where convergence

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\(^1\) Market participants can use convergence bidding to leverage their position in the CRR market. The problem is well known, well documented, and can be mitigated using a simple settlement rule.
bidding implemented at the nodal level has resulted in unjust prices, market manipulation, or adverse impacts on consumers. Conversely, there is at least one documented instance where customers were demonstrably harmed by the absence of nodal convergence bidding as DC Energy demonstrated with its example of price behavior at the Astoria generation in New York City.

As WPTF has pointed out in its other comments, voluntary convergence bidding provides an important tool for hedging a number of market risks, including congestion between nodes; it limits price divergence between the Day-Ahead and Real-Time markets; it augments the DMM’s ability to ensure that prices are fair by “putting more eyes on the street”; it adds to market liquidity and enhances price discovery; and it offers a simple, elegant way for market participants to ensure that scheduling practices don’t distort prices – without requiring burdensome administrative rules that could adversely impact market outcomes.

Regarding process timing, the CAISO has indicated that it “intends to design and develop software systems with capability for nodal virtual bidding as well as LAP-level or some other aggregation of pricing nodes.” The CAISO has also indicated that it “…is currently drafting documentation specifying the software requirements for such a configurable system. The CAISO anticipates developing an implementation schedule in coordination with appropriate vendors during the first quarter of 2008.” We would also like the CAISO to provide a date by which stakeholders will know whether the CAISO will, in fact, build nodal-based functionality so that there’s some certainty about what is actually being built.

The CAISO raised four primary points with respect to the timeline extension in its November white paper. For each we offer our observations and comments.

a) Allow more time for stakeholder consideration

There have been extensive stakeholder meetings and numerous opportunities for discussion. WPTF believes that the issues have been identified and argued, that no new information is coming to light and that parties with strong opinions have exhausted their arguments. There are, however, some implementation details that merit further discussion as we discuss in item c) below.

b) Allow for the observation of five months of the redesigned LMP markets

It would be helpful to know with more specificity what the CAISO expects to learn by observing market operation for five months and how that information will influence its thinking on granular convergence bidding. At the November stakeholder meeting some CAISO staff suggested that the CAISO would look at whether prices converged, but said nothing about how price convergence (or the lack thereof) would affect the decision on granularity. Other CAISO staff indicated the purpose of the observation period was to ensure that flaws in the CAISO software could be observed and identified. If this is true, WPTF suggests the CAISO clarify whether the presence of such flaws would cause the CAISO to recommend against granular convergence bidding, as granular convergence
bidding itself is intended to help the market function in the presence of such flaws rather than leaving SCs exposed and with no other remedies.

WPTF also suggests the CAISO define what it means by software “flaws”. WPTF believes for example, that since the CAISO network model does not include all of the WECC, there are likely to be actual loop flows that are not reflected in the DAM prices. This is a natural outcome of the policy direction the CAISO has taken rather than a software “flaw” and we would object to any attempt to delay granular convergence bidding on the basis that the CAISO’s network model is inadequate or incomplete.

WPTF urges the CAISO to develop a balanced set of assessment criteria. In addition to looking for flaws, the assessment criteria should allow the CAISO to identify market outcomes where nodal convergence bidding would be beneficial, much like the Astoria example cited earlier.

c) Focus next year’s discussions on the specific recommendations by the CAISO’s Department of Market Monitoring,

It appears the DMM has largely settled on a list of mitigation techniques it will require under both nodal and LAP-level convergence bidding, but there are still some implementation details that need agreement. These include CRR forfeiture rules and perhaps another discussion on position limits.

d) Rely on guidance from the Market Surveillance Committee (MSC), which has been heavily involved.

Last August, the MSC seemed to offer the opinion that the CAISO could proceed with granular convergence bidding on the condition that it initially impose position limits that could be lifted later as market confidence increased. To the best of our knowledge there are no new outstanding issues that the MSC has identified for which it suggests more consideration into 2008.

In summary, WPTF asks the CAISO to:

(a) provide a date by which it will commit to implementing the capability to support a nodal design, and
(b) do one of the following, either
   (i) provide a recommendation to the Board in early 2008 for a granular design based on the work that has been done to date, the consensus opinion, and the MSC’s opinion on this issue; or in lieu of doing so
   (ii) identify before the end of 2007 specifically what actions it will undertake further, including what specific issues related to granularity will be worked through the stakeholder process in 2008 and a basis for the number of stakeholder rounds necessary to work these issues, and design the specific test it will apply (if any) to the
post-go-live LMP data that will determine whether the CAISO will recommend a granular design or some other design.

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

WPTF agrees with the CAISO’s design proposal regarding the characteristics of virtual bids. We do not think caps on virtual bids are necessary because caps in the Real-Time market already provide adequate safeguards, but we do not object to them, either.

WPTF also suggests that the CAISO continue to explore the notion of allowing convergence bidding at hubs and control area scheduling points by studying how the Eastern ISOs address such bids and understanding the outcomes. While it is unlikely that market participants will want to trade at every single node in the CAISO footprint, willing buyers and sellers should be able to conduct their business at any node they choose so long as there are no demonstrably adverse impacts on market outcomes. The CAISO needs to also work through whether there are legitimate impediments to convergence bids at Gen Hubs, including looking for analogs in other ISO markets.

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

WPTF supports the proposed changes. They ensure more realistic market outcomes without resorting to cumbersome administrative rules.

WPTF supports posting information on virtual bids, but that information should be released on the same schedule as physical bidding information. WPTF does not find any basis for releasing financial bidding information on a time frame that is different from the time frame for releasing physical bidding information. Moreover, establishing separate release time frames discriminates against market participants that engage in one activity (e.g., physical) more than another activity (financial).

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

WPTF supports the credit policy and credit processes that were contained in the CAISO’s November 7, 2007 paper. They meet the CAISO’s need for timely information on market participant exposure without imposing commercially onerous conditions on virtual bidders or exposing other market participants to undue financial risk.

5. **What are your entity’s views on the CAISO’s proposal (explained at the November 14 2007, meeting) for allocating costs for virtual transactions?**
Please refer to WPTF’s earlier comments on this topic. WPTF supports using cost-causation to allocate costs but benefits have to be credited to those who produce them on a similar basis. This means IFM costs should not be allocated to virtual transactions unless RUC benefits are credited to virtual transactions. For example, virtual bids in the IFM that have the effect of driving demand in the Day-Ahead market closer to actual load as measured in Real-Time should not be treated as if they have a net adverse impact on the market. If the CAISO commits certain units in RUC based on its load forecast, then virtual transactions are simply causing a comparable level of capacity to be committed as part of the market processes and perhaps earlier than they otherwise might. In that sense IFM commitment costs should never be allocated to virtual demand when the total IFM demand is less than the CAISO forecasted demand.

WPTF has commented on this extensively and would be pleased to provide detailed examples of appropriate settlement calculations when the CAISO is prepared to adopt a balanced cost-causation approach.

WPTF also notes that the CAISO’s proposal is unlikely to be enmeshed in the same dispute, raised by an attendee at the November 14 stakeholder meeting, that the MISO finds itself in with respect to costs allocated to virtual bids. The MISO’s situation stems from a lack of clarity in their cost allocation proposal, and conflicting information in their tariff and their business practice manual. The CAISO’s proposal is clear and we expect the MRTU tariff and BPNs to agree.

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

WPTF agrees with CAISO’s conclusion that the proper way to address such potentially adverse interactions is to explicitly watch out for them. If they do occur, then the CAISO should take action to limit any activity that causes prices in the Day-Ahead and Real-Time Markets to diverge from one another. We note that this hypothetical problem could only exist at specific nodes and for specific participants, which makes more expansive monitoring unnecessary. Moreover, imposing restrictions preemptively without clear evidence that there is a problem could needlessly lead to adverse impacts on market outcomes.