Williams Power Company, Inc.'s Comments on Convergence Bidding Issues
June 13, 2007

Williams Power Company, Inc. (“Williams”) appreciates the opportunity to submit these comments on convergence bidding (“CB”), including the CAISO’s May 31, 2007 paper regarding Key Elements for the Conceptual Proposal for Convergence Bidding in the MRTU markets.

At this point – seven months before the scheduled date of MRTU implementation and at least 19 months before CB is required to be in place - there simply is no need to pursue a crippled initial implementation of CB. CB is not an unknown or unproven market mechanism. Every ISO with a two-settlement LMP market (except for the CAISO’s MRTU market) has implemented CB, and years of operational and regulatory experience have accumulated from these markets. Every one of those ISO markets, with the exception of one (NYISO1), has implemented CB at the nodal level. There is nothing unique about the CAISO’s two settlement LMP market that would suggest either that the substantial experience from these other ISO markets is somehow inapplicable in California or that the CAISO must implement a CB design with intentionally-crippled initial functionality or onerous initial collateral requirements and test-drive that crippled design for an undetermined period before moving to the level of functionality and credit requirements already successfully in place in other markets for some time. Thus, Williams takes issue with the characterization on page 5 of the May 31, 2007 white paper that issues previously discussed, but not part of the May 31 white paper (such as CB granularity), are “largely resolved.”

The rest of Williams’ comments deal with issues discussed in the May 31 white paper.

Allocation of CAISO uplift charges

In general, Williams agrees with the CAISO’s positions on cost allocation set forth in the white paper. However, Williams urges the CAISO to reject the overly simplified notion that virtual demand is the same as physical demand and should therefore be allocated all the same costs. Williams agrees with the MSC that while allocating no uplift costs to virtual transactions would be going too far, it is beneficial to keep the virtual market as deep and liquid as possible so costs should be levied on virtual transactions with care.

Allocation of IFM commitment charges

Williams also continues to oppose the blanket allocation of IFM commitment charges to net virtual demand. There is no logical reason to allocate IFM commitment charges to virtual demand to the extent that virtual demand merely increases IFM unit commitment to the level that would occur if all demand cleared in the DA market. Tier 1 IFM or RUC commitment costs should be allocated to virtual demand only if and only to the extent that virtual demand increases demand beyond the level of actual load. While Williams acknowledges that it may be equitable to allocate RUC commitment costs incurred because the CAISO mistakenly committed too many units under RUC to both virtual and metered demand, Williams hopes and expects that such costs will be small and infrequent.

Allocation of GMC charges

NYISO has acknowledged that the lack of nodal level convergence bidding has yielded sub-optimal price convergence. As the NYISO stated, “In general, virtual trading and price sensitive load bidding help improve convergence by facilitating arbitrage of day-ahead and real time prices. However, the NYISO is currently unable to allow market participants to submit virtual trades and price sensitive load bids at the load pocket level, only at the zonal level, making it possible for price convergence to be good at the zonal level, but not in individual load pockets.” New York ISO 2005 State of the Market Report at 22 (available at: http://www.nyiso.com/public/webdocs/documents/market_advisor_reports/2005_NYISO_SOM_Final.pdf.)

The NYISO continued: “The large systematic differences in the load pockets would provide significant incentives for market participants to arbitrage, but virtual trading is limited to the zonal level. This is [the] primary reason why price convergence has been far better at the zonal level than at the load pocket level.” Id. at 23.

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Williams notes that the CAISO did not offer a specific proposal – only options - and agrees that this issue will play out as the GMC under MRTU takes shape. Williams agrees that it is reasonable for market participants benefiting from a convergence bidding system to bear the costs of that system. Further, it is reasonable to construct a charge – similar to the third method described in the CAISO white paper – which allocates some costs based both on the possible benefit of using the CB system (i.e., submitting a virtual bid) and the bulk of costs on benefits actually incurred (e.g., having the bid clear). Williams would also hope the CAISO would extend this approach to all CAISO systems, including the CRR system, which, in theory, can provide benefits to any market participant, but in practice will likely provide benefits only to a much smaller group of market participants.

Credit

Williams reiterates that the CAISO should be able to build upon the experience of other ISOs in regards to credit and need not impose stringent credit requirements initially with the hope of relaxing them over time. Again, as the MSC has pointed out, given that convergence bidding will have positive impacts on the CAISO’s markets, the CAISO should not build artificial barriers to participating in the virtual markets.

To promote liquidity in the virtual market, Williams supports calculating the estimated liability for convergence bidding activity using a two-day exposure window. Williams also believes that a 97% risk level (i.e., using the 97th percentile of price variation over a historical period as a measure of potential liability) is too high and should be reduced to a level that would reflect a single standard deviation of variance.

In regards to other credit parameters, Williams generally supports the parameters adopted by PJM or MISO – (1) allowing market participants to use a high level of posted credit (85% or higher); (2) allowing two or three days for posting; and (3) a daily credit check.

Williams again thanks the CAISO for the opportunity to provide these comments.