

October 27, 2008

Board Chair Mason Willrich
Board Member Linda Capuano, Ph.D.
Board Member Laura Doll
Board Member Tim Gage
Board Member Thomas A. Page
Mr. Yakout Mansour, President and Chief Executive Officer

Subject: Western Power Trading Forum Comments to the Board of Governors on the CAISO's Proposed Price Cap Policy

Dear Mr. Mansour and CAISO Board of Governors:

WPTF certainly wants a successful implementation of MRTU. However, WPTF has significant concerns about the CAISO's proposal to implement a price cap and floor.

In short, WPTF does not believe that this additional level of price mitigation has been justified. Not only is it a late addition, the staff admits that it is a type of price mitigation that exists in no other RTO market. Instead it is based only on the rationale I quote from page 1 of your board memo:

"The price cap would be put in place to guard against **unknown** issues and **unusual circumstances** that **could** arise due to changes in market participant **behavior** that result in **unreasonable** market outcomes."

The CAISO points to potential market participant behaviors that could create unreasonable market outcomes - - a justification the CAISO has not offered on this topic in prior stakeholder activities. At the same time the staff says with respect to the MRTU prices:

"Despite their small impact on overall revenue requirements, however, these prices play a critically important role in sending the right operational price signals and in guiding transmission, generation and demand response investment." (p.1)

The proposed price cap is not warranted. The CAISO does not indicate when or under what conditions this price cap would be lifted. The proposed cap does not ensure transparency and the proposal lacks necessary details explaining why \$2500 is the appropriate value and illustrating how the cap would be implemented. For example, the CAISO must verify that no revenue neutrality impacts will occur, explain how Ancillary Service, energy and congestion pricing will be affected, and explain how CRR settlement would be affected.

We have prepared an attachment that further details deficiencies of the CAISO proposal.

We urge you to reject Management's proposal to implement this unjustified price cap. MRTU already contains protection against unreasonable prices, including a low offer cap and stringent local market power mitigation. However, should you approve this proposed cap, we ask that you require Management to provide these missing details before approving this proposal because the information presented does not demonstrate that the proposed cap is necessary, nor does it provide sufficient information about how it will be implemented.

Thank you for your consideration.

Sincerely,

A handwritten signature in cursive script that reads "Ellen A. Wolfe".

Ellen Wolfe

For WPTF

Attachment - Specific Deficiencies with the CAISO Proposal

1. The market power mitigation design was established through extensive stakeholder discussion and deliberations by the MSC and FERC in 2006. One key element of the final design was an acknowledgement that while *bids* were capped, and bids from units needed to address local constraints may be mitigated, nodal *prices* were not capped, and nodal prices would reflect the price of serving demand in constrained areas while being based on the capped/mitigated bids. The CAISO proposal modifies this fundamental approach to mitigation.
2. Management has provided very little substantive rationale for the cap and no analysis indicating why the proposed level of the cap (+/- \$2500) is the appropriate level. During the stakeholder meetings, the CAISO indicated that the need for a price cap was predicated upon concerns stemming from technical aspects of the MRTU system software, and that the early deployment of MRTU needed to have a safety net to ensure that such outcomes could be prevented. In the Board Memo, the staff is now telling the Board that the need for the price cap is predicated upon the possibility of unreasonable outcomes resulting from changes in market participant behavior. The Board should ask the staff to explain what market behaviors they have observed or that have been observed by other market monitors that requires this new form of mitigation.
3. The CAISO staff seems confident that the systems and policies that support MRTU have now been proven. The CAISO staff assures us that all CAISO market systems are calculating prices properly and are working as designed. (Board memo on 60-day filing, p.7). The Analysis of Pricing by LECG has found no substantial issues that cause prices to be inconsistent with the tariff.¹ (LECG Final Report, p. 4) The CAISO has further explained that any extreme prices they have seen so far are mostly caused by an EMS simulator used only for market simulation conditions or are consistent with the simulated market outcomes. The right way to deal with any unanticipated or unusual market outcomes is to investigate and resolve the underlying market and software issues, not to do a pre-emptive price modification.
4. The CAISO also indicates in its board memo that the price is being: “set to a level that would allow the proper price signals to flow through to the market while protecting against extreme market outcomes.” But provides no rationale that supports \$2500 as

¹ LECG did find discrepancies with the levels of schedules and dispatches, but not specifically with respect to pricing.

the right number. WPTF believes that a price cap threatens the formation of “proper price signals”.

5. The CAISO board memo itself explains why a price cap is inappropriate and unnecessary when it notes “[d]espite their small impact on overall revenue requirements, however, these prices play a critically important role in sending the right operational price signals and in guiding transmission, generation and demand response investment.” (p.1). The important point, and the reason that a price cap is harmful and excessive, is that a cap eliminates all instances of prices going above or below the cap and therefore weakens incentives to manage that risk through forward purchases and other risk management mechanisms. If the instances to which the staff is referring have a small impact on overall prices yet provide a critically important role in guiding investment and operating decisions for transmission, generation and demand response, it makes no sense to undermine these prices with the proposed cap.
6. Critical pieces of information about the use of the cap are missing from the information that staff has made available. For example
 - a. Rather than imposing constraints on the model solution, our understanding is that the price cap would be imposed by “clipping” prices after the fact. What inefficiencies are introduced by this approach? What parts of the LMP (congestion, losses or energy) will be modified by the cap and how? This has impacts throughout MRTU, including hedging products like CRR payments. If an LMP would be \$3000 but for the \$2500 cap, then how will the CAISO determine what part of the \$2500 is due to energy, what part is due to losses and what part is due to congestion?
 - b. At this late date, will the CAISO’s systems be able to post both the actual LMPs and the capped LMPs? Not posting the true LMPs will entirely undermine transparency and distort price signals for the cases where the transmission or generation investment is most needed. Not posting the capped LMPs will make it impossible for an SC to predict its fundamental energy payments and charges.
 - c. It is simply is not clear how the CAISO will invoke the cap. For example, will they simply replace prices after-the-fact?

These and other details have not been made available, yet the CAISO proposes to go forward with its FERC filing.

7. The CAISO has offered no firm sunset date. Instead, the CAISO has suggested only that it will revisit this during the first year of MRTU. If the price cap is implemented in spite

of the unresolved issues described above, there should be a firm sunset date of no more than six months beyond the “go live” date. If the CAISO staff believes that it needs to be extended, they should justify the extension in a Section 205 filing at FERC.

8. The board memo states that the CAISO will not rely on these price controls as “a substitute for prompt and thorough investigation of the causes of all extreme prices and the development of appropriate remedies”. If the Board approves Management’s proposal, then it should require Management to provide periodic reports that describe the intervals, nodes, settlement consequences and underlying reasons in each situation where the cap is triggered.

We fully support protections that avoid improper market outcomes, but we do not believe the Board should approve this late, unsubstantiated proposal for additional price mitigation, as it lacks analysis of the impacts, reasonable technical justification of the need for, and level of proposed caps, as well as the specification of the reporting requirements necessary to assure transparency. We appreciate the Board’s careful attention to this matter.