

Comments of Calpine Corporation on
California ISO Payment Acceleration Project
Discussion Draft
May 30, 2008

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Summary:

Calpine supports the CAISO efforts to accelerate the cash-clearing schedule. Calpine agrees with the drivers of this initiative as stated in the whitepaper -- that the current cash-clearing cycle exposes market participants to “undue credit risk” and it may “hinder resource availability..., challenges credit management and exposes market participants to additional risk in the event of defaults...”

Further, Calpine concludes that introduction of the MRTU Day-Ahead (DA) market is likely to greatly increase the magnitude of both CAISO cash clearing and these “undue” risks as a significant majority of the energy and capacity required to serve all CAISO load is cleared in the Day-Ahead processes.

However, Calpine suggests that the proposals embedded in the CASIO whitepaper can be greatly improved. Calpine proposes a bifurcation of DA and Real-Time settlements. In the attached – coined as a Commercial Cash Clearing (CCC) proposal --Calpine observes that much of the complexity of settling CASIO markets resides in the substantial data requirements of Real Time (RT). Alternatively, all of the data required to settle the DA market exists the instant the IFM and RUC processes close on T-1. As noted in the attached, this substantial difference in data requirements and timing could lead to a “natural separation” in settlements.

Calpine’s CCC proposes that high frequency DA market invoicing and weekly cash clearing be implemented the later of Feb1, or the implementation of MRTU. The RT settlement and cash-clearing could stay on the current schedule until it too, is accelerated to weekly settlement 6 months after implementation of MRTU.

Calpine has discussed this proposal with many market participants as well as CAISO staff and will work cooperatively to implement the principles of CCC while

- preserving the CAISO focus on implementation of MRTU, and
- minimizing, any required changes to either the tariff or software systems.

Commercial Cash Clearing
Proposed Principles
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Background:

The CAISO settlement cycle currently has cash clearing approximately 90 to 95 days after the beginning of the trade month (approximately 40 days after bilateral markets clear, and 35 days after natural gas payments are due.)

As the ISO states in its whitepaper, this cash clearing cycle exposes market participants to “undue credit risk” and it may “hinder resource availability..., challenges credit management and exposes market participants to additional risk in the event of defaults...” The introduction of a Day-Ahead market which is likely to clear a significant majority of the required energy in MRTU is likely to greatly magnify these “undue” risks.

Principles for Commercial Cash Clearing (CCC):

- CCC should significantly lower collateral requirements and default risk by minimizing the delay between market activity and settlement.
- CCC should use in-scope MRTU software to the extent possible.
- CCC should be implemented as soon as practicable.
- CCC should minimally distract CAISO staff as it readies the systems to Go-Live
- CCC should be implemented, to the extent possible within the four corners of the current tariff.
- The CAISO proposal, as contained in the May whitepaper does not adequately address market participant concerns
- CCC should result in a reduction in credit requirements, commensurate with the reduction in market risk, to promote market entry

Benefits of CCC

- Reduces the magnitude of any potential market default, associated uplift to the market, including systemic risk, all the while lowering collateral requirements for participants, which will reduce barriers for participants to participate in the market
- Lowers costs by avoiding interest-related costs, commercial credit sleeves and costs associated with potential default risk.
- Is consistent with FERC guidance
- Consistent with identified best practices by the Committee of Chief Risk Officers
- Encourages participation in, rather than avoidance of CAISO markets
- Encourages bidding and better optimization rather than self-scheduling

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Proposal

Bifurcate DA and RT settlement

The new CAISO DA market is a financially-binding commitment. All data required for settlement are present at the close of the DA market. Specifically, no estimations or meter data are required for settlement of the DA hourly market.

On the other hand, the RT market requires either meter data or estimates of consumption and dispatch. This fundamental difference in data requirements leads to a natural separation of settlements. There does not appear to be anything in the approved MRTU tariff which would prohibit this bifurcation.

Settle DA markets weekly

FERC has encouraged, and most other organized markets either settle, or have plans to settle on a weekly basis in order to address the credit and default risks identified above. Indeed, it is estimated that weekly settlements could reduce collateral requirements by 80 percent compared to today.

The current settlement software, SaMC has been designed to invoice on a daily basis so there are no apparent software limitations to high frequency settlements. In addition, it appears that there is the possibility that RT settlements can be “turned off” in order to produce only DA settlements.

Implement CCC with MRTU Go-Live

Changes to the DA settlement should be effective on Feb 1, 2009, or the date of Implementation, whichever is later. This would allow time to make the rather modest changes required to bifurcate DA and RT settlements and clear the DA markets on a higher frequency.

Settle RT markets on the current settlement schedule for no more than 6 months after MRTU implementation.

Since the RT market is intended to be an imbalance market, the volumes and dollars are anticipated to be less significant. Therefore, delayed RT settlement, while troubling, has lower impact. Nonetheless, the CASIO should implement cash clearing of both RT and DA on a weekly basis no later than 6 months after startup.