Stakeholder Comments Template

Subject: Ex Post Price Correction Make-Whole Payments for Accepted Demand Bids

Submitted by (name and phone number)	Company or Entity	Date Submitted
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As a follow-up to the discussion during the December 23 stakeholder conference call, the ISO welcomes written comments on the Straw Proposal for Ex Post Price Correction Make-Whole Payments for Accepted Demand Bids ("Straw Proposal") dated December 16, 2009. This template is offered as a guide for formulating stakeholder comments and for any additional comments that participants may have based on the discussion during the call. Documents related to this meeting are posted at: http://caiso.com/2453/2453ab8e10ff0.html. Written comments should be submitted by close of business on Tuesday, January 5, 2010 to: dliu@caiso.com.

Please comment on the following design issues and the proposed solutions discussed in the Straw Proposal.

1. What is your entity's view on the make-whole payment calculation method?

CEI believes the CAISO should move away from calculating the make-whole payments based on bid segments and move towards basing the calculation on the final bid accepted. During the stakeholder conference calls, it appears that most market participants agree with CEI and would prefer that the CAISO use the final bid accepted settlement to derive make-whole payments. Moreover, there is nothing in the materials provided by the CAISO that supports the need to solve for every anomaly or potential market inefficiency. Without such evidence, it is not clear why the CAISO would adopt the proposed settlement mechanism for make-whole payments when market participants would be adversely affected financially instead of settling based on the LMP price.

CEI also is concerned about the unintended consequences on the way in which market participants may adapt their bidding in response to the CAISO's settlement proposal. Market participant bids settle one way when the LMP clears properly and in a different way when there is need for make-whole payments due to price corrections. If placed in a position of having to choose a bid structure based on these two separate settlement methodologies, a market participant likely would bid with the worst case scenario in mind. The example below, based upon one of the CAISO's own example,[1] highlights that bidding to accommodate the worst case scenario could decrease liquidity and/or increase risk premiums both overall prices:

Original Price $20 Corrected price $80

The suggested make-whole implicit price ($55.90) or roughly 2.24 times the lowest bid price accepted (55.9/25) means that the implicit price is 2.24 times the price a market participant was willing to pay for the entire bid curve and yet the market participant was accepted on the entire bid curve. From CEI's perspective, based on the limited data available to it, the CAISO is asking market participants to bear the risk of an adverse alternate settlement based on something completely out of the control of the market participant.

Bid Curve Settlement	Bid Price	Bid Segment	Suggested Make-Whole	LMP[2]
0	$75	150	$750	$8250
150	$65	50	$750	$2750
200	$60	50	$1000	$2750
250	$55	50	$1250	$2750
300	$50	40	$1200	$2200
340	$45	35	$1225	$1925
375	$40	25	$1000	$1375
400	$35	50	$2250	$2750
450	$30	25	$1250	$1375
475	$25	25	$1375	$1375
500				
			$12050	$27500

Import transactions will benefit based on the traditional LMP settlement when price changes occur in their favor. However, exports will be required to settle based on bid segments. Continuing with the above example, an importer of 500 MWs would have originally received $10,000 ($20*500 MWs) for its import. With the price correction, the importer would collect the full benefit of the price correction – $40,000 ($80*500 MWs). In contrast, the exporter only receives 43% of the traditional LMP settlement. In this case, the exporter is short changed $15,450 based on an uncontrollable situation that changed the settlement of its export megawatts.

In Section 3 of the Straw Proposal, the CAISO includes its analysis of the impact of a price correction under its preferred approach.[3] The results of that analysis are included

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[1] See December 16, 2009 Straw Proposal Ex Post Price Correction Make-Whole Payments for Accepted Demand Bids ("Straw Proposal") at 4.

[2] This column is calculated based on the LMP settling at the lowest bid accepted using the traditional MRTU LMP settlement methodology.

in Table 3. Has the CAISO assessed what the make-whole payments owed to market participants if they were based on the final bid accepted? If it has, then the CAISO should make those alternative assessments available to market participants. If the CAISO has not, then it should because it appears from the data that is available to CEI that the impact is significant. For example, using the percentages discussed above and Table 3, the bid segment approach short-changes the market by an incremental combined (HASP & DA) $2 million when compared to the outcome if the CAISO were to use the final bid accepted. Accepting that we may not have a complete understanding of the final bids accepted as they pertain to Table 3, the data we do have suggests that the "Total" value in Table 3 is a fraction of what the true value would be if the CAISO used the traditional LMP settlement approach that CEI supports. In discussing its analysis and the presentation in Table 3, the CAISO states that the "day-ahead price corrections is minimal, and the monetary impact to HASP price correction is also relatively small."[4] The example provided above shows that these "minimal" impacts are actually quite sizable – the final bid accepted approach yielding nearly twice what is shown in Table 3's "Total" column – and need to be explored more before the CAISO selects its make-whole payment calculation method.

CEI appreciates that its assessment may not be entirely correct because it does not have access to the same data available to the CAISO. However, from CEI's perspective, these examples show that the CAISO is asking market participants to bear the risk of an adverse alternate settlement based on something that is completely out of their control. To help manage such risks, market participants may consider decreasing bid prices for export, increasing prices for imports, reducing bid volume or increasing risk premiums, all of which lead to market inefficiencies that largely could be avoided by using the final bid accepted to calculate make-whole payments.

2. What is your entity's view on the proposed make-whole payment approach for virtual bids?

See above.

3. What is your entity's view on the proposed make-whole payment settlement?

See above.

4. Other comments.

CEI has outline several reasons why the CAISO should calculate make-whole payments based on the final bid accepted. Other stakeholders have expressed support for this approach, as well. If the CAISO wants to use the bid segment calculation method, it

[3] Straw Proposal at 6-7.

[4] Straw Proposal at 6.

should provide its reasoning for preferring that approach over the final bid accepted approach so that market participants can have a complete understanding of the basis for that decision. This explanation should include any reliability, market power or other concerns that the CAISO is attempting to address by adopting the bid segment settlement solution and any alternative solutions the CAISO considered.