

COMMENTS OF THE SACRAMENTO MUNICIPAL UTILITY DISTRICT ON DRAFT FINAL CAISO IBAA PROPOSAL

INTRODUCTION

The Sacramento Municipal Utility District (SMUD) hereby submits its comments on what the California Independent System Operator (CAISO) describes as its “*Draft Final CAISO Integrated Balancing Authority Area (IBAA) Proposal*” (Draft Final IBAA Proposal), dated April 18, 2008. The title of the document itself begs the question whether the proposal is subject to any further material change or whether it is largely final. If the latter is the case, then the request for comments raises a question as to whether the stakeholder process at this point is just a vehicle to enlist proofreaders rather than a bona fide effort to engage market participants in a search for an outcome that will enjoy broad consensus. SMUD will assume for purposes of these comments that the CAISO has not spoken its final word on the proposal, but is sincerely interested in the views of stakeholders and still has an open, persuadable mind on the subject.

Although the CAISO’s Draft Final IBAA Proposal makes one significant change to its earlier version of the proposal – the move to single hub pricing – it is largely unchanged, or silent with respect to several of the concerns raised by stakeholders in prior comments. Those concerns deal primarily with questions of process – how future IBAs will be developed, whether there will be future Section 205 filings to implement new IBAs, what the CAISO will include in its planned Section 205 filing to implement its IBAA proposal, whether the CAISO’s methodology for development of, or changes to, distribution factors will be incorporated into its Market Redesign and Technology Upgrade (MRTU) tariff, what proof the CAISO relies on to conclude that the SMUD Balancing Authority (BA) Area has a larger impact on the CAISO grid

than other neighboring balancing authorities etc. SMUD's comments will not dwell on those concerns. SMUD simply notes that, although labeled a "Final Draft," the latest proposal largely ignores the substantial volume of public comments it not only received, but invited on these questions.

Finally, SMUD observes that the proposal continues to evolve, but not in response to the comments of stakeholders. Rather, the changes proposed – in particular the new proposal for two single hub prices (one for exports and one for imports) – seem to have been driven by very recent CAISO discussions with the Market Surveillance Committee about what it terms concerns about "inappropriate scheduling." The result is that instead of seeing revisions addressing their objections, stakeholders face a constantly moving target. So, although the CAISO has discussed the IBAA concept with stakeholders over the last few months, the latest Draft Final IBAA Proposal, although related to its earlier progeny, is entirely new, having only recently been conceptually introduced to those involved in the IBAA process.¹ Thus, what began ostensibly as an exercise to improve the modeling of neighboring balancing authorities and to improve the CAISO's ability to manage congestion, has now shifted to a discussion about concerns over market gaming. This is troubling for those attempting to assess the impacts of the IBAA proposal on their customers. Moreover, it makes it hard to develop solutions when the CAISO continues to redefine the problem it is attempting to resolve or its rationale.

A. The Key Defects in the CAISO's "Single Hub Default Pricing Rule"

As noted above, the key feature of the CAISO's latest -- and arguably "final" version of its IBAA proposal is its decision "to establish a "single-hub" default pricing rule for pricing

¹ The CAISO discussed it conceptually at an IBAA technical meeting on April 8, 2008 and further at the Market Surveillance Committee on April 11, 2008.

intertie transactions between the CAISO and the SMUD and TID IBAs.” Draft Final IBAA Proposal at 2. Under that proposal, “all imports to the CAISO from the SMUD and TID IBAs will be priced based at the Locational Marginal Price (LMP) calculated at the Captain Jack Sub-Hub or Proxy Bus, while all exports from the CAISO to the SMUD and TID IBAs will be priced at the LMP calculated at the SMUD Sub-Hub or proxy bus.” *Id.* Although the timing is left unclear, the CAISO also proposes an alternative pricing option – to be available “*if* the CAISO is provided more detailed information regarding the resources supporting a specific scheduled intertie transaction.” *Id.* Under its alternative, “the CAISO *may* agree to specific exceptions to the default pricing rule” and allow pricing based on the location of specific resources if it receives “detailed information that either supports identification and verification of the marginal resources supporting the applicable scheduled intertie transaction or otherwise supports CAISO efforts to increase the accuracy of its congestion management solutions. *Id.* at 14 (emphasis added.)

There are two principal defects in this proposal. First, it is prompted to solve a problem – gaming -- that, by the CAISO’s own account is only theoretical. Second, it adopts a “heads I win, tails you lose” solution to that problem that simply raises import prices for those purchasing resources from within the CAISO grid and reduces the prices the CAISO will pay for resources its market participants will import.

1. Theoretical “Inappropriate Scheduling.” According to the CAISO, the new proposal was prompted by a desire “to eliminate inappropriate scheduling incentives and pricing signals likely to result if the IBAA modeling and pricing mechanisms are not aligned,” Draft Final IBAA Proposal at 2, notwithstanding that, the “single hub” pricing would “*reduce* modeling accuracy (and thus the accuracy of the CAISO’s congestion management solutions)”

Id. at 7-8. The choice is curious since the CAISO also says that “*more accurate modeling is necessary* because of the high level of interconnection between the CAISO’s Balancing Authority Area and the proposed SMUD/TID IBAA.” *Id.* at 4. (emphasis added). In fact, after describing the elimination of “inappropriate scheduling incentives” as its first priority, it later describes its “core” objective as the “improve[ment] of FNM’s accuracy in modeling the IBAA.” *Id.* at 4. But the incongruity of the choice aside, it is not based on any evidence of “inappropriate scheduling.” On the contrary, during its meeting with representatives of TANC, Western and SMUD, those representatives pointed out that there would be little reason and no practical opportunity for such activity. Indeed, after describing the “concern” about this problem, the CAISO says only that it “reevaluated the proposed Multiple Hub IBAA pricing methodology *to determine if* the use of multiple hub prices would establish inappropriate pricing scheduling incentives.” *Id.* at 11 (emphasis added) But it never says whether it *made* that determination (i.e., that the problem existed even in theory) or, more importantly, whether there was any evidence of a real life problem. Initiatives to address market behavior concerns, however, should be reserved to address real, not theoretical problems. *Standards of Conduct for Transmission Providers*, 122 FERC ¶ 61,263 at P 37 (refusing to adopt rule aimed at “theoretical instances of abuse” “[i]n the absence of evidence of actual abuse”) (citing *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D. C. Cir. 2006))

2. Heads I win, Tails you lose. The existence of an “inappropriate scheduling” problem aside, the CAISO’s solution -- separate single hub prices for imports and exports -- simply does not comport with its stated objective to achieve “more accurate modeling.” Draft Final IBAA Proposal at 4. On the contrary, the only outcome the proposal *assures* is that it will raise export prices from the CAISO and lower prices for imports into the CAISO market. This may well be of

benefit to CAISO market participants, but it does not achieve the loftier stated goal of getting the prices right.

The flaws in the CAISO's approach are obvious. If the prime objective is to eliminate "inappropriate scheduling incentives," this could be achieved by pricing exports into the CAISO Balancing Area at a different single point than Captain Jack. There is no inherent reason why the use of Tracy would not achieve the same objective. And the CAISO cannot claim that its approach is based on producing accurate results. By its own account, the "more" accurate multi-hub approach it earlier advocated was *itself* inaccurate without more information from the neighboring IBAA. Draft Final IBAA Proposal at 8. Indeed, the CAISO says that, "[b]ased on the frequency and severity of the inaccuracies resulting from the implementation of CAISO's initial IBAA methodology (Single Hub), the CAISO may elect to implement these enhancements as soon as several months after MRTU start up." (Id.) In other words, the inaccuracies – which it knows now exist – may be of such "severity and frequency" that the CAISO will need to revise its IBAA mechanism only months after MRTU is implemented. *Id.*

Recognizing the inherently greater inaccuracy problems with its single-price hub, the CAISO expresses its willingness, noted earlier, to consider "specific exceptions to the default pricing rule," i.e., pricing from the resource, *if* it is provided sufficient data. *Id.* at 14. On its face, this alternative may sound unobjectionable, but what it means is that, absent an agreement, the CAISO will implement a pricing methodology it not only *knows* is inaccurate, but intends to revisit only months after MRTU start up.

Worse, from the perspective of CAISO's neighbors, is that the single hub pricing methodology it plans to implement is so plainly designed to favor its own market. By pricing all

exports from the SMUD/TID IBAA at Captain Jack (when it does not know where the source originates) artificially depresses the price of those exports. And the different hub it chose for the pricing of exports *from* the CAISO market serves to inflate *those* prices. In other words, a “heads I win, tails you lose” scenario, not a principled attempt to get the prices “right.”

In this light, where the CAISO insists that it cannot delay implementation of the IBAA proposal until after MRTU start up (but is apparently assuming that it will change the IBAA mechanism “as soon as several months after start up “(Id. at 8)), neighboring balancing authorities are understandably skeptical about the CAISO’s planned use of additional data. There is already considerable data exchanged between neighboring balancing areas in the WECC, but, by agreement, the data is to be used only for *reliability* purposes. The use of such data to price CAISO markets is not inherently objectionable, but it is cause for concern when the perceived objective is to favor the CAISO market, not merely to improve the accuracy of its pricing models.

Finally, the ostensible concerns about “inappropriate scheduling” are curiously *not among the topics the CAISO has asked stakeholders to comment upon in its comment template*. On the contrary, the template focuses on whether stakeholders believe the CAISO proposal adequately addresses the CAISO’s stated objective to “ensure that there will not be large differences between scheduled intertie transactions (and scheduled flows) with the IBAA’s and actual intertie transactions (and actual flows) with IBAA’s.” As to *this* issue, the problem is difficult to understand. Presently, the SMUD and CAISO balancing areas maintain limits on the deviations between scheduled and actual interchanges on a system to system basis (that is, an integrated number reflecting total interchange with all ties consolidated to a single interchange value.) Flows at the individual interconnections are monitored to ensure that they remain within

safe operating limits. Further, the CAISO has not presented documentation for its assertion that congestion management cannot be accomplished effectively using its state estimator. SMUD BA members could assist the CAISO in calibrating its estimator by sharing after-the-fact data to test and adjust the CAISO estimator. The CAISO relies on a state estimator for operating its system which has distribution factors for schedules at interties with the SMUD IBAA. If those tools need adjustment to increase their accuracy, SMUD BA staff can work with the CAISO staff to check CAISO state estimator predicted results against after-the-fact data, so refinements to the CAISO model can be made if needed. This is far better for all parties than the unilateral approach that the CAISO is currently proposing.

B. Remaining Uncertainties about the Nature of the CAISO’s Alternate Proposal.

SMUD noted above that the CAISO has proposed an alternative pricing option: it may agree to specific exceptions to the default pricing rule” and allow pricing based on the location of specific resources *if* it receives “detailed information that either supports identification and verification of the marginal resources supporting the applicable scheduled intertie transaction or otherwise supports CAISO efforts to increase the accuracy of its congestion management solutions. *Id.* at 14. SMUD is not averse to considering this alternative, provided, as it and TANC have stated, that the CAISO honors existing agreements recognizing the ability of the TANC members to utilize the COTP without having their transactions priced at Captain Jack. The alternative itself, however, is highly ambiguous.

For one thing, the timing is left unclear. The CAISO proposes that its alternative pricing option will be available “*if* the CAISO is provided more detailed information regarding the resources supporting a specific scheduled intertie transaction. *Id.* (emphasis added) But this does not tell SMUD or others whether the CAISO will go forward with its single-hub pricing rule if

an agreement is still being negotiated, but has not been concluded. When will customers know of its decision? When will it be implemented – before MRTU? If not, why not delay implementation of the IBAA proposal until negotiations over information exchange are completed?

Equally uncertain are the ground rules for qualifying for the exception. The CAISO says only that it “*may* agree to specific exceptions” if it gets the information it wants. *Id.* at 14 (emphasis added) At page 15, the CAISO adds that it will work with entities “on a case-by-case basis.” What discretion does the CAISO have in these situations and how is consistent treatment going to be ensured?

C. Process for establishing New, or Modifying Existing IBAA

In section 5 of its Draft Final IBAA Proposal, the CAISO suggests its need for an IBAA process to address stakeholder concerns when it contemplates the addition of a new IBAA or the modification of an existing one. SMUD certainly supports the CAISO’s adoption of a process to address these circumstances. But its belated acknowledgement of the problem and the need for a solution raise two questions.

First, while we appreciate the CAISO’s decision to create a more structured process for the consideration of future IBAAAs or the modification of existing ones, this gives little comfort to the initial IBAAAs. The CAISO now apparently contemplates that it will “seek collaboration and conduct a consultative process with affected BAAs and its stakeholders,” and that it will seek both Board and FERC approval for its proposals. Draft Final IBAA Proposal at 18. If these protections are important, why weren’t they accorded to the initial IBAAAs? The process should be established *before* the adoption of the current proposal.

Second, the CAISO, by now, should have a detailed process to propose. Instead, there is only a vague reference to such a process without any specific details. The fact is, but for the problems with the integrated market testing for MRTU and associated delays, we would already be operating in a MRTU market structure. Yet, the CAISO has not adopted a formal IBAA process.

D. Additional Concerns/Questions

At the IBAA Technical meeting the CAISO held on April 9, it first previewed the concept of a single hub. The CAISO noted that such a proposal was becoming a preferred option by some in CAISO management and the Market Surveillance Committee. The CAISO noted that any such single hub proposal would require a much larger set of distribution factors than were currently being proposed to capture the interaction between the IBAA entities. Additionally, these would be less static than those in the original proposal. Although section 2.3 of the IBAA Proposal purports to provide “Specific Details of the IBAA Single-Hub Modeling Methodology,” there is no elaboration on this point. In light of this:

- When does the CAISO plan to develop this new set of distribution factors?
- Does the CAISO intend to discuss these proposed distribution factors with so-called IBAAAs?
- Since the distribution factors are intended to be dynamic, what will be the process for change management?

E. Other Comments

Several other parties have also submitted comments on the Draft Final IBAA Proposal. SMUD has had an opportunity to review the comments of TANC, Silicon Valley Power and the Western Area Power Administration and shares their concerns as well as the concerns articulated above. In particular, SMUD agrees with the observation by TANC that an IBAA should be the result of a negotiated solution between neighboring IBAA's and that the CAISO should also have followed a robust stakeholder process before it determined to proceed with its proposal. SMUD also agrees with Silicon Valley that, if the CAISO's interest was in more accurate modeling, there are alternatives that it could have – and still can – explore before it implements its proposal. And, as SMUD has previously stated, Silicon Valley correctly notes that the CAISO's proposal fails to address the inequity of applying its new IBAA to CRR nominations that have already been made, while recognizing that when the CAISO makes *future* changes to IBAA's after CRR nominations have occurred, affected parties will have the opportunity to reevaluate and adjust their nominations.