J.P. Morgan Comments on CAISO Straw Proposal Mitigation and Allocation of Real-Time Imbalance Energy Offset Costs (CC 6477)

Submitted by	Company	Date Submitted
Steve Greenleaf *(916) 802-5420*	*J.P. Morgan Ventures Energy Corporation and BE CA, LLC (Together, J.P. Morgan)*	*October 2, 2009*

J.P. Morgan appreciates the opportunity to provide these comments on the CAISO's September 23, 2009, Straw Proposal entitled "Mitigation and Allocation of Real-Time Imbalance Energy Offset Costs (CC 6477)" (Straw Proposal).

J.P. Morgan continues to support the development and implementation of a two-tiered cost allocation methodology. J.P. Morgan recommends adoption of a two-tiered cost-allocation methodology because it is aligned with cost-causation and will establish appropriate incentives for market participants to schedule and otherwise participate in the market in a manner that enhances overall market efficiency.

Background

As stated by the CAISO in its original August 24, 2009, Issue Paper, the CAISO has initiated a near and long-term effort to address high charges under CAISO charge code 6477, Real Time Imbalance Energy Offset. The CAISO stated in the Issue Paper that April amount billed through this charge code was $14.13 million to Measured Demand. The CAISO states that it has identified two key drivers for the imbalance energy offset charges:

- Significant differences between HASP and RTD energy prices combined with high volumes of HASP energy (the CAISO states that this results in significant disparity in the cost of settling supply in the HASP and the settlement of real-time demand); and
- The effect of using an average energy hourly price for real-time imbalance energy settlement.

With respect to HASP-RTD price differences, the CAISO stated that significant over-scheduling of load in the day-ahead IFM has resulted in depressed HASP prices. As a result of over-scheduling and resultant over-generation, CAISO operators have introduced downward biases in real-time forecasts and have exercised exceptional dispatch to reduce import energy and increase export energy. In addition, in order to secure sufficient ramping capacity, CAISO operators have also increased internal generation (to create more ramping capacity) and therefore had to decrease imports and increase exports (sell of excess HASP energy). Both of these factors –

over-scheduling in the day-ahead and insufficient ramping capacity - have contributed to lower HASP prices and the divergence between HASP and RTD prices.

With respect to the effect of price averaging, the CAISO stated that hourly-averaging – as opposed to pricing on an interval-by-interval basis - results in load being charged less when deviating upward and being paid more when deviating downward.

In order to address this issue and the above-identified system/market conditions on a long-term basis, the CAISO identified the following four potential options:

- Option 1 is to develop a two-tier allocation for the Imbalance Energy Offset. Under this option, for Imbalance Energy offset charges, allocate the cost first (tier 1) to positive net Uninstructed Imbalance Energy and then (tier 2) to measured demand. The CAISO reasons that since positive net Uninstructed Imbalance Energy is a primary factor behind HASP negative instructed imbalance energy, such load should pick up the costs.
- Option 2 is to identify and address the causes of the large energy price differentials between RTD and HASP.
- Option 3 is to align the time intervals used for settlement of RT load Uninstructed Imbalance Energy and generation. To do so, the CAISO would use state estimator results to estimate Uninstructed Imbalance Energy for load for each settlement internal and settle those imbalances using the applicable interval price. This would fix the price averaging issue discussed above.
- Option 4 would be to use the RTD price to settle HASP tie transactions. The CAISO states that this option is similar to an approach on which the NYISO has recently been working.

On September 23, 2009, the CAISO issued a Straw Proposal on the longer-term options. In the Straw Proposal the CAISO stated that:

> While the ISO has made progress in evaluating the causes of large price difference between RTD and HASP, price differences will continue to persist to some extent into the future due to the asymmetry created by settling hourly intertie schedules at prices generated in the HASP run and internal load and generation at RTD prices… It is therefore important to reassess the current allocation rule for the offset charge in light of the analysis discussed above and determine what if any changes are warranted.

The CAISO continued that:

> Stakeholders are nearly unanimously against option 4 of settling the HASP energy using the RTD price. Stakeholders are divided between the 2-tier allocation with positive UIE as the basis for tier 1 versus the alternative of leaving the cost allocation as is (spread pro rata to measured demand) and continuing further analysis to identify and mitigate the root causes of the large price differentials between RTD and HASP.

The CAISO Straw Proposal that discussed the merits of both a two tiered allocation scheme and continuing with a single allocation to measured demand. With respect to the two-tiered

allocation, the CAISO proposed an expansion of its original proposal "to reflect cost causation more accurately and address HASP-to-RTD cost deviations in either direction." The CAISO proposes to extend the billing determinant from just the positive UIE of load to include negative UIE of supply resources in RT (i.e., delivering less energy than scheduled or instructed), in situations where net interchange scheduled in HASP was in the export direction. With respect to the single-tiered allocation, the CAISO states that the rational for staying with a single-tiered allocation is that real time imbalance energy offsets can occur due to a variety of factors and thus it is difficult to attribute these costs to specific entities or actions. The CAISO concludes that therefore the best approach may be to mitigate the price differentials to the extent possible and continue to allocate these costs pro rata to measured demand.

Comments

Consistent with its September 4, 2009, comments, J.P. Morgan continues to support adoption of a two-tiered cost-allocation methodology. As stated previously, J.P. Morgan agrees with the CAISO that the offset charges are largely a consequence of load over-scheduling in the day-ahead market and the CAISO's resulting actions. In addition, J.P. Morgan conceptually agrees that the negative uninstructed deviations of supply resources in real-time may also appropriately bear some of the identified offset costs. J.P. Morgan recommends adoption of a two-tiered allocation methodology as such a methodology is appropriately aligned with cost-causation. A two-tiered allocation methodology will create both an incentive for load to not over-schedule in the day-ahead market and manage the amount of positive net Uninstructed Imbalance Energy in the market and for supply resources to minimize negative uninstructed deviations that could exacerbate HASP and RT price differences.

J.P. Morgan supports the adoption of cost-allocation methodologies that are aligned with cost-causation and that establish appropriate incentives for market participants to take actions aligned with reliable operation of the system and increasing overall market efficiency. The CAISO's proposed two-tiered allocation methodology is consistent with both of those objectives. Moreover, J.P. Morgan does not believe that adoption of a two-tiered methodology will in any way unfairly burden one segment of the market. As pointed out by the CAISO, in instances where there is a very small amount of day ahead load over-scheduling or under-scheduling, offset costs resulting from any HASP-RT price differentials would be allocated to tier 2 – all measured demand.

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