J.P. Morgan Comments on CAISO's Straw Proposal for Modifying Rules Limiting Supply Bid Pool in Integrated Forward Market

Submitted by	Company	Date Submitted
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J.P. Morgan Ventures Energy Corporation and BE CA, LLC (collectively, "J.P. Morgan") appreciates this opportunity to provide comments on the California ISO's (CAISO's) August 7, 2009, Straw Proposal for Modifying Rules Limiting Supply Bid Pool in Integrated Forward Market ("CAISO Straw Proposal").

Background

The CAISO stated that it was considering potential changes to the Supply Bid Pool rule because, while the existing rule has generally worked as expected, the rule "has the potential to raise overall costs in the IFM in some situations." (CAISO Straw Proposal at p.3). The CAISO cited to market results from two hours on July 26, 2009, where IFM demand cleared approximately 7% higher than the CAISO demand forecast. The CAISO states that, as a result of limited supply resources, the IFM cleared at a high priced segment of the bid-in demand curve and average LAP prices rose to $400-500/MWh.

The CAISO Straw Proposal identifies the following four potential approaches to determining the pool of supply resources available in the Integrated Forward market ("IFM") for market clearing of bid in supply and demand:

- Approach 1 – Use all bids in the IFM, regardless of whether the resources are dispatched or not in the Market Power Mitigation ("MPM") run.

- Approach 2 – Use all bids conditionally in the IFM. Under this approach, the MPM and IFM runs will be performed as they are today and only bids from resources dispatched in the MPM process will be made available in the IFM. However, the CAISO could re-run the IFM if certain thresholds are satisfied. For example, if demand cleared in the IFM is higher than the CAISO's load forecast by more than a pre-established threshold, the CAISO would re-run the IFM using all supply bids.

- Approach 3 – Use the greater of the CAISO demand forecast and bid-in demand in the MPM process. Under this approach, the greater of the CSO demand forecast and bid-in demand would be used in the MPM run and only bids dispatched in the MPM run would be made available to the IFM.

- Approach 4 – Use bid-in demand in the MPM process. This approach is consistent with FERC's direction to the CAISO in its September 21, 2006 order on the new market. The CAISO considers this approach to be linked with Convergence Bidding and, at present,

intends to implement this approach when it implements Convergence Bidding (currently anticipated for Spring 2011).

In addition, two additional approaches for addressing this issue were identified on the CAISO's August 14, 2009, conference call on this matter. First, the CAISO acknowledged that an "Approach 5" would be to maintain the status quo and to make no changes to existing MPM and IFM processes until such time as Approach 4, above, and Convergence Bidding are implemented. Second, Southern California Edison Company ("SCE") proposed an alternative approach that is similar to Approach 3 proposed by the CAISO (greater of demand forecast or bid-in demand), except that an artificial demand curve would be substituted for actual bid-in demand. SCE proposed that such demand curve be constructed to approximate Load Aggregation Point ("LAP") demand bid in at a "reasonable" price. SCE identified a number of options for determining the proxy reasonable price, including the cost of a peaker, a percentage (50% of the bid cap), and use of a historic, similar-period price.

Comments

J.P. Morgan does not support making any modifications to the existing MPM and IFM rules and processes at this time. First, the CAISO supports its need to modify the existing Pool of Resources rule based on two hours of market results. J.P. Morgan is concerned that the CAISO is pursuing solutions to a problem (high prices under certain limited market conditions) best addressed by the market itself. The "anomalous" market results from the two hours on July 26th may in fact be a logical consequence of a high level of self-scheduling combined with a lack of price-sensitive demand bid into the market.

Second, while J.P. Morgan is sensitive to the need to address certain previously identified deficiencies in the CAISO's market rules and processes, it appears that the best long-term solution is that which FERC directed the CAISO to implement by Release 2 of the new market, i.e., use of bid-in demand in the MPM (Approach 4, above) and implementation of Convergence Bidding to discipline bidding behavior in the market. Unfortunately, as acknowledged by the CAISO, these measures are best implemented in tandem and Convergence Bidding cannot be implemented until early 2011.

Third, the alternative approaches identified by the CAISO and SCE suffer from flaws. Approaches 2 and 3 include discretionary (conditional) elements that introduce uncertainty in the market and may unnecessarily and artificially interfere with market participant bidding behavior. For example, as acknowledged by the CAISO, Approach 3 could create incentives for load to bid in a manner than inappropriately suppresses market clearing prices. Similarly, SCE's proposed approach is based on an administratively determined demand curve that would unnecessarily interfere with market outcomes. The CAISO's Approach 1 may be best among a set of poor available choices. However, it too suffers from potential drawbacks. As examined by the CAISO, although Approach 1 is the simplest to implement, Approach 1 may "significantly increase" the IFM software run time. While J.P. Morgan may be able to support implementation of Approach 1 as an interim measure until Approach 4 and Convergence Bidding can be implemented , J.P. Morgan cannot do so until the CAISO has fully evaluated the potential impact of implementing this measure on CAISO systems, software run time, and other important pending design/system changes.

J.P. Morgan appreciates the opportunity to submit these comments and looks forward to further participation in this process.