Order 764 Compliance
15-Minute Scheduling and Settlement
10/23/12 Straw Proposal
Comments of Morgan Stanley Capital Group, Inc.
Submitted November 16, 2012

Morgan Stanley Capital Group, Inc. (MSCG) has reviewed the Straw Proposal published by the CAISO on October 23, and listened to the stakeholder conference held on October 30. Conceptually, MSCG believes the proposal is a fundamentally sound approach to the joint challenges of complying with Order 764, and restoring convergence bidding at the interties. We have long advocated a full three-settlement resolution to the problem of excess RTIEO created by the differences between hourly intertie prices and internal real-time LMPs. Assuming our understanding of it is accurate, the current Straw Proposal indeed takes just that approach.

Perhaps more importantly to MSCG, we see the Straw Proposal as resolving the objections to convergence bidding. We see convergence bidding at the ties as crucial to managing the importation of variable energy resources' production into California, notwithstanding the Department of Market Monitoring's assertion that market participants had not been using convergence bidding to hedge related risks. In our view, restoration of convergence bidding at the ties should be one of the CAISO's highest priorities.

While we are encouraged at the prospect of returning virtual bids to the interties, we would need to see the proposed market design presented in much greater detail in order to fully evaluate the merits of the structure. We suggest that any virtual product must be fungible with the physical to facilitate hedging, and it appears that in the proposed design there is a disconnect between pricing of physical congestion in HASP and settling virtuals in the 15-minute market. We are also not certain that barring virtuals for internal nodes from the 5-minute market allows creation of an appropriate hedge for internal resources and external resources that are exposed to physical curtailments. In addition, as we've expressed in the past, we support some version of the E-tag limit to address the dual constraint issue, and believe CAISO's "Option A' proposal does not successfully resolve that issue.

Our gaining a full understanding of the proposal will most likely take some additional explanations by the CAISO of aspects that it has already thought through, as well as fleshing out other aspects that (we suspect) even the CAISO has only peripherally considered. We anticipate that the next iteration of the Straw Proposal will contain significant extra detail to facilitate such understanding. To that end, we offer the following incomplete list of questions and proposals to assist with the development of that second iteration:

1. <u>Additional bids for Transmission above offered energy levels.</u> Energy bids in HASP carry with them an implicit bid for transmission to deliver on the energy. However, it is possible to bid for additional transmission over and above your

energy bid. What form will this additional transmissions bid take (i.e. is it $/MWh, does it cover only the congestion component of the 15 minute LMP, can you get the extra transmission for some 15 minute intervals but potentially not all 4 - 15 minute intervals in a given hour, etc.)? Also, if you do procure extra transmission above your energy schedule in HASP but then don't use it, and there is congestion in the 15 minute market, are you paid the congestion charge since you 'released' transmission space into a congested market? Can you procure this extra transmission space in DA or just HASP? Some more detailed guidance around how this will work will be helpful.

2. <u>Meshing hourly bids with CAISO 15-minute dispatch</u>. It is clear that if you do not want your schedules to change every 15 minutes in RT then you should self schedule. If you do put an economic bid on your resource, and it is not dispatched in HASP, the economic bid survives into the 15 minute market and you may still get dispatched up or down based on that bid. During the discussion at the Stakeholder conference, there was some dialogue about being able to put a flag on your economic bid such that if you are not dispatched in the HASP market, then you state you do not want to participate further in the 15 minute market. MSCG strongly supports this suggestion. Indeed, we would like to see availability of a flag to say that you want a 'block' dispatch in HASP (i.e. the same for each 15 minute interval).

   Our expectation is that if the CAISO does not allow for this, then there will be vastly more self-schedules than there are now (people will do this to be assured of a block dispatch). Even if the WECC transmission market moves to 15 minute scheduling, many suppliers (i.e. utilities) may still not accommodate marketers changing hourly schedules every 15 minutes. A change for the whole hour could be accomplished with such a flag. Any resource that can truly respond to 15 minute changes is still free to let its economic bid survive into the 15 minute market.
3. <u>Coordination with WECC.</u> CAISO stated that it is coordinating development of 15-minute protocols with WECC. MSCG strongly supports the CAISO doing so. That said, we suggest that such coordination not unduly inhibit the development and implementation of a strong vigorous structure as fast as possible. There is a risk that Balancing Authorities will have widely divergent views on how to meet FERC's requirements, which could bog down the WECC process. If this occurs, the failure of the WECC process to move forward as quickly as the CAISO shouldn't result in a delay in deployment. If the functionality is installed and approved by FERC, we anticipate that this could actually accelerate the WECC process. Coordinate, of course, but don't design your systems to the lowest common denominator.
4. <u>Inability to respond to 15-minute dispatch.</u> MSCG strongly supports creating a capability in the software to put in an operational constraint "flag" on a unit, indicating an inability to respond in the 15 minute market. In particular, we believe this is a "must have" for VERs; a lack of wind/sun should be considered a valid operational constraint for not responding.
5. <u>Penalty Pricing.</u> During the stakeholder meeting, some market participants strongly advocated instituting a "worst-of" pricing rule for any bidder that does

not deliver on its 15 minute schedule. MSCG believes such a step is not justified in the initial design. We recommend observing how the new features "play out", rather than going directly to a "penalty pricing" regimen. We do not see any reason why there will be a persistent, predictable bias between the 15 minute market and the 5 minute RT market that could be exploited. Also, the flex ramp charges will flow back to uninstructed schedules via an uplift, providing an "extra" disincentive. Finally, internal resources aren't subject to worst-of pricing, so intertie likewise should not be subject to this without a well documented need for it. Therefore, while we do not object to holding a "penalty pricing" option in reserve, it should not be deployed until an ongoing, systemic problem that must be resolved is documented.

6. Internal and Import Parity. MSCG advocates parity of treatment for internal and external resources. This proposal removes many practical, historical reasons for not having done so previously. As part of this process, we would like to see the CAISO formally and officially adopt this principle. It is particularly important with regard to situations in which Bid Cost Recovery is in play. In particular, lack of Bid Cost Recovery for hourly block importers that is available to internal resources is inequitable, is likely to reduce liquidity, and thereby potentially impairs reliability. This is because, at least as so far described, hourly block bidders appear to be wearing the risk of price changes between the hourly and 15 minute prices.

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