

October 28, 2009
Board of Governors
California Independent System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630

Dear Governors:

SUBJECT: Board Decision on Convergence Bidding

Convergence bidding is an integral part of all deregulated electricity markets across North America and consumers in these markets have benefited from its inclusion in the design of these markets. The CAISO two-settlement market would be incomplete without the inclusion of convergence bidding, as it would complement the market by adding efficiency, liquidity and market power mitigation. Convergence bidding will do the following:

- Converge day-ahead and real time prices to provide for a more efficient dispatch.
- Mitigate market power by adding competition to the market.
- Provide a hedge for physical supply and demand positions.
- Enhance the accuracy of the day-ahead unit commitment, allowing a more efficient and stable next day real time market.

Convergence bidding is a financial tool that would provide these benefits to the CAISO market. It is important to understand that convergence bidders have an incentive to bid in the day-ahead market *up to the point of convergence, and not beyond*. If a convergence bidder attempts to exercise market power by offering a large amount of megawatts for sale at a single node and at a very low price, for example, the bidder would undoubtedly lose money on the transaction. If the convergence bidder attempts to game the market by purposely losing money in the convergence bidding market in order to gain larger amounts of money in the CRR markets, the CRR settlement rule will ensure that any such gains will be forfeited.

The task of implementing convergence bidding has not been taken lightly by CAISO staff. Extensive efforts have been made by CAISO staff and stakeholders to craft a convergence bidding proposal that is both fair and

beneficial to the marketplace. The current proposal offers real benefits to participants in the CAISO market while providing many checks to prevent abuses (position limits, a dynamic credit policy, CRR settlement rule, etc.). After four years of debate, the process has clearly run its course and the time has come to take the next step in the implementation process. EPIC and JPTC supports the implementation of the current CAISO convergence bidding proposal.

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