

**TO:** YAKOUT MANSOUR, CAISO GOVERNING BOARD MEMBERS  
**FROM:** GARY ACKERMAN AND ELLEN WOLFE, WESTERN POWER TRADING FORUM  
**SUBJECT:** SUPPORT FOR CONVERGENCE BIDDING BOARD APPROVAL INCLUDING FERC FILING  
**DATE:** OCTOBER 27, 2009

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Convergence bidding will fill a critical gap in the CAISO's market design. Your approval at this time will ensure that there are no further delays in filling this functional gap.

The Western Power Trading Forum (WPTF) strongly urges the Board to approve the CAISO's motions on nodal convergence bidding. WPTF also asks the Board to endorse CAISO's plans to (1) file its convergence bidding design with FERC by November 13, and (2) prepare and file tariff language by January 2010. The reason is simple: Convergence bidding will fill a critical gap in the CAISO's two-settlement market design, as recognized by FERC when they ordered the CAISO to implement convergence bidding within one year of MRTU market start-up. Your approval at this time will ensure that there are no further delays in filling this functional gap. WPTF emphasizes the following points:

- **Nodal convergence bidding is a critical element for improving market efficiency and market power mitigation in LMP markets.**

Matching of buyers and sellers for electricity contracts is particularly challenging since power in LMP markets is priced nodally and locations of natural (physical) sellers do not always coincide with locations of natural (physical) buyers. Including nodal convergence bidding increases nodal competition and serves to mitigate nodal market power. This in turn improves dispatch efficiency and increases price transparency.

- **CAISO Market Participants, in the absence of well-designed Convergence Bidding, are without critical hedging capabilities.**

Every month that convergence bidding is not in place, CAISO market participants – especially those without balanced portfolios (e.g., participants who do not own or control both load and generation, such as merchant generators and retail energy service providers) – are without a tool for critical hedges. Here are two examples.

- Energy Service Providers cannot hedge real-time congestion today.  
An Energy Service Provider (ESP) who has been allocated or has purchased Congestion Revenue Rights (CRRs) is hedged only for day-ahead congestion; the ESP is at risk for the congestion cost of any load served in real-time that was not forecasted due to load forecast errors. Convergence bidding allows an ESP to hedge this risk, effectively settling their CRRs in real-time.
- Generators cannot hedge real-time risks today.  
A generator that schedules expected generation in the day-ahead market is at risk if the plant suffers a derate or an outage after the day-ahead awards are made. Nodal convergence bidding allows generators to manage that risk. The ability to manage that risk ensures that the generator can schedule the most expected generation in the day-ahead, enhancing the reliability of the day-ahead commitments, because convergence bidding provides a hedge against the high real-time prices that the generator would need to pay in the aftermath of an unexpected outage.

Functionality that provides hedging tools such as these is critical. As most market participants are naturally exposed to nodal prices, nodal convergence bidding is necessary to offer adequate hedges for those participants. FERC ordered convergence bidding to be in place within one year of MRTU startup, and it is appropriate to approve the design and direct the staff to prepare a FERC filing accordingly.

- **Convergence Bidding design is standard practice with all other US ISOs**

Every other US organized electricity nodal market has convergence bidding, and market operators and market monitors find the functionality to be beneficial to producers and consumers alike. Each of these markets either has convergence bidding at the nodal level (ISONE, PJM, MISO) is moving to a nodal design (NYISO), or will include it upon launching a nodal market (ERCOT).

Further, the CAISO has carefully assessed the convergence bidding designs in other markets throughout the development of the proposal before you, and has been able to use the experience of other regions to make improvements in the market design. For example, the CAISO's CRR settlement rule is more robust than PJM's given improvements offered by the CAISO, and the CAISO's cost allocation provisions are more precise than those of the North Eastern ISOs.

- **The CAISO has conducted an extensive and thorough stakeholder process on these issues**

WPTF provided a letter to the Board on this topic last month (September 24, 2009), attached herein for convenience. As demonstrated by that memo, the three-and-a-half year CAISO convergence bidding stakeholder process has been one of the most extensive efforts ever undertaken for a single initiative. The CAISO should move forward in the process at this time to ensure no additional delays are created.

- **All significant policy issues have been vetted**

It is likely that a few parties still oppose moving forward with convergence bidding at this time. As the CAISO's Board memo indicates, this opposition has been long standing and these differences will not be solved at the CAISO stakeholder level. This does *not* mean that the staff has left any important design elements unresolved. In fact, the CAISO staff should be commended for having turned over every possible "rock" related to convergence bidding. To the extent that peripheral issues remain for further stakeholder review and input, the further refinement of these peripheral issues is not necessary for a successful implementation of nodal convergence bidding. There are separate processes underway to continue those discussions. For instance:

- Residual Unit Comment or “RUC” issues will be addressed as part of a stakeholder process on start-up and min load bidding. As the potential for market power in the RUC process is not particularly applicable without the ability to frequently change bids for start-up and minimum load costs, any concerns should be addressed via that process;
- Intertie scheduling requirements will be addressed in a stakeholder process that began this month, and additional intertie design details will continue to be addressed as the CAISO prepares its BPM and tariff language; note that the CAISO has not confirmed that any actual issues exist yet has proposed tight position limits in order to err on the conservative side;
- Local market power mitigation will be revisited by DMM and the MSC in the upcoming year as a result of other FERC-mandated activities, and both the DMM and the MSC have found the CAISO’s current proposal addressing market power to be reasonable;
- GMC rates will be addressed as part of the annual GMC process, and the current convergence bidding rate structure is consistent with that of other markets.

In summary, the convergence bidding stakeholder process has been long, detailed, and rigorous. All issues relevant for the FERC conceptual design filing CAISO plans to make November 13 have been thoroughly investigated. Whereas WPTF does not agree with every single feature of the CAISO’s proposal, we believe the CAISO staff has done a superb and entirely complete job of addressing the instant convergence bidding policies. It is time for the process to move forward.

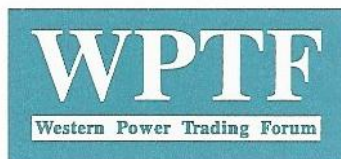
Thank you for the opportunity to express our position and for your consideration.

Sincerely,



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Attachment: September 24, 2009 WPTF Memo to the CAISO Board on Convergence Bidding



**TO:** YAKOUT MANSOUR, CAISO GOVERNING BOARD MEMBERS  
**FROM:** GARY ACKERMAN AND ELLEN WOLFE, WESTERN POWER TRADING FORUM  
**SUBJECT:** RESPONSE TO OTHER PARTICIPANT'S CHARACTERIZATION OF CONVERGENCE  
BIDDING PROCESS  
**DATE:** SEPTEMBER 24, 2009

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The Western Power Trading Forum (WPTF) strongly supports the CAISO management's conduct of the convergence bidding policy stakeholder process. We are concerned, however, about other parties' recent statements regarding the CAISO's process and would like to set the record straight. WPTF offers this memo to confirm that (1) the convergence bidding stakeholder process has been extensive and should culminate in October with a Board decision, (2) the CAISO recommendation for a nodal design is consistent with its intentions expressed in its long-running stakeholder process, and (3) the CAISO design is consistent with other ISOs' implementation of convergence bidding and provides functionality applauded by other ISOs and their market monitors.

**1. The CAISO's Stakeholder Process has been extensive and robust and warrants closure at this time**

Certain parties believe that the CAISO has "shortened" or "abruptly truncated" its stakeholder process on convergence bidding, and that the CAISO is "rushing its design through with minimum debate".<sup>1</sup> There have been no shortcuts, no trimming the edges, and no lack of debate in the CAISO's process.

The CAISO's convergence bidding stakeholder process has been the longest and deepest stakeholder process the CAISO has ever conducted for any single market enhancement. (The attached shows a

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<sup>1</sup> See for example comments from PG&E of August 24, 2009 (<http://www.caiso.com/2418/2418e4664b3d0.pdf>). Recall also oral comments provided at the September Board meeting by Elizabeth Dorman of the CPUC whereby the CPUC characterized the CAISO's stakeholder process as "hasty" and "abbreviated", and characterize the CAISO's actions as "...rush[ing] the design through with minimal debate".

timeline of the events of this stakeholder process.) The process has spanned more than three years, and has included the following.<sup>2</sup>

- 13 in-person stakeholder meetings including 3 in-person joint MSC/Stakeholder meetings;
- 5 additional stakeholder conference calls;
- 70 sets of stakeholder comments;
- 20 CAISO white papers;
- 20 CAISO appendices, technical documents or example documents;
- 20 CAISO PowerPoint presentations;
- Presentations from representatives of the NY ISO, the NE ISO, PJM and MISO; and
- Public presentations from stakeholders such as SCE, PG&E, and WPTF.

Based on the 2006 FERC Order directing the CAISO to implement convergence bidding within 12 months of MRTU implementation, and given the expected MRTU start-up date at the time, the stakeholder process would have terminated nearly a year ago. In 2008, the CAISO indicated that it anticipated observing approximately five months of market activity before bringing key policy issues to the Board.<sup>3</sup> This stakeholder process already leaves a disproportionately short timeline for FERC resolution once the CAISO design is filed (in January if the Board decision occurs in October) and thereby already risks further implementation delays.

Notably, stakeholder positions on key issues such as whether to implement a nodal vs. zonal design have remained unchanged. Given that parties have moved little from their initial positions, additional stakeholder process is highly unlikely to result in stakeholders reaching consensus on design issues.

For the above reasons it is entirely appropriate for the Board to hear and rule on the convergence bidding design in the October Board meeting. All comments to the effect that the process has been abbreviated are simply not accurate.

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<sup>2</sup> Based on the CAISO web site and in cases rounded up or down by one.

<sup>3</sup> “Finalizing Convergence Bidding Policy Development”, CAISO presentation to stakeholders, October 16, 2008. (<http://www.caiso.com/2060/2060e691180e0.pdf>)

**2. The CAISO recommendation for a nodal design is consistent with its stakeholder process and intentions over the past two years**

Parties have indicated in oral comments during stakeholder meetings that the CAISO has reversed its decision and made an abrupt decision to pursue a nodal design for its convergence bidding market. In November 2007 the CAISO began pursuit of a strategy to design systems such that they could accommodate either a zonal or nodal design, indicating that they would review the MRTU market outcomes before selecting a course of action.<sup>4</sup> This approach was repeated in May of 2008 when the CAISO indicated it was deferring granularity policy decisions until after several months of market operations,<sup>5</sup> and again in October 2008, when the CAISO stated that the “[p]olicy for the granularity of virtual bids will be determined after MRTU markets are running” and that they would take approximately five months to observe the markets.<sup>6</sup> The CAISO has precisely followed this plan. Statements to the contrary are not accurate.

**3. The CAISO recommended design is consistent with other ISOs’ design and the functionality is applauded by other ISOs and market monitors**

The CAISO’s proposal for a nodal design is consistent with other ISOs’ convergence bidding design.<sup>7</sup> Some participants have suggested that the convergence bidding functionality creates new, exotic, financial instruments of which some industry experts have been critical. These participants may be confusing statements made regarding other products that are unrelated to convergence bidding.

In fact, ISO personnel throughout the U.S., including the ISOs’ market monitors, believe that convergence bidding is a critical piece of functionality that improves the markets’ functioning. Statements of industry experts supporting the role of convergence bidding include the following:

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<sup>4</sup> Updated on the Design of Convergence Bidding, (<http://www.aiso.com/1c95/1c95d64c2c8e0.pdf>), November 14, 2007, p. 3.

<sup>5</sup> Review of Convergence Bidding Design: Issues Discussed to Date, (<http://www.aiso.com/1fbb/1fbb76b013150.pdf>) May 2, 2008, p. 3

<sup>6</sup> Finalizing Convergence Bidding Policy Development, (<http://www.aiso.com/2060/2060e691180e0.pdf>), October 16, 2008, p. 2 and p. 4.

<sup>7</sup> WPTF notes that the NYISO uses an approach that is zonal in nature, although somewhat more granular than a CAISO – LAP based approach would be. However, the NYISO Market Monitor, David Patton, indicates that the NYISO’s movement to a more granular virtually bidding design would improve price convergence and he identifies it as one of the important improvements the NYISO is making. 2008 State of the Market Report, David Patten et. al. ([http://www.nyiso.com/public/webdocs/documents/market\\_advisor\\_reports/NYISO\\_2008\\_SOM\\_Final\\_9-2-09.pdf](http://www.nyiso.com/public/webdocs/documents/market_advisor_reports/NYISO_2008_SOM_Final_9-2-09.pdf)) See for example p. 46 and p. xix.

- “If we did not have financial participation, we might as well shut it down. Essentially, the market could not function without financial participation, period.” (Andy Ott, PJM’s Senior VP of Markets.)<sup>8</sup>
- The role of financial participants in the regional transmission organization markets “is critical” (Joe Bowring, PJM’s market monitor)<sup>9</sup>
- “Liquid virtual supply and demand is an important component of the Midwest ISO market because it: (a) Facilitates convergence between the day-ahead and real-time markets; (b) Mitigates market power in the day-ahead market; and (c) Reduces day-ahead price volatility.” (MISO Independent Market Monitor, 2007)<sup>10</sup>
- “...without virtual traders, revenue sufficiency guarantee payments would go up.” David Patton, Independent Market Monitor, during 8/20/08 Board meeting.

In summary, WPTF thanks the CAISO management and staff for their extensive and prudent actions related to the convergence bidding stakeholder policy process and urges the Board to disregard unsupported statements made by some market participants and to continue to support a timely resolution of the policy issues by ruling on design issues at its October meeting.



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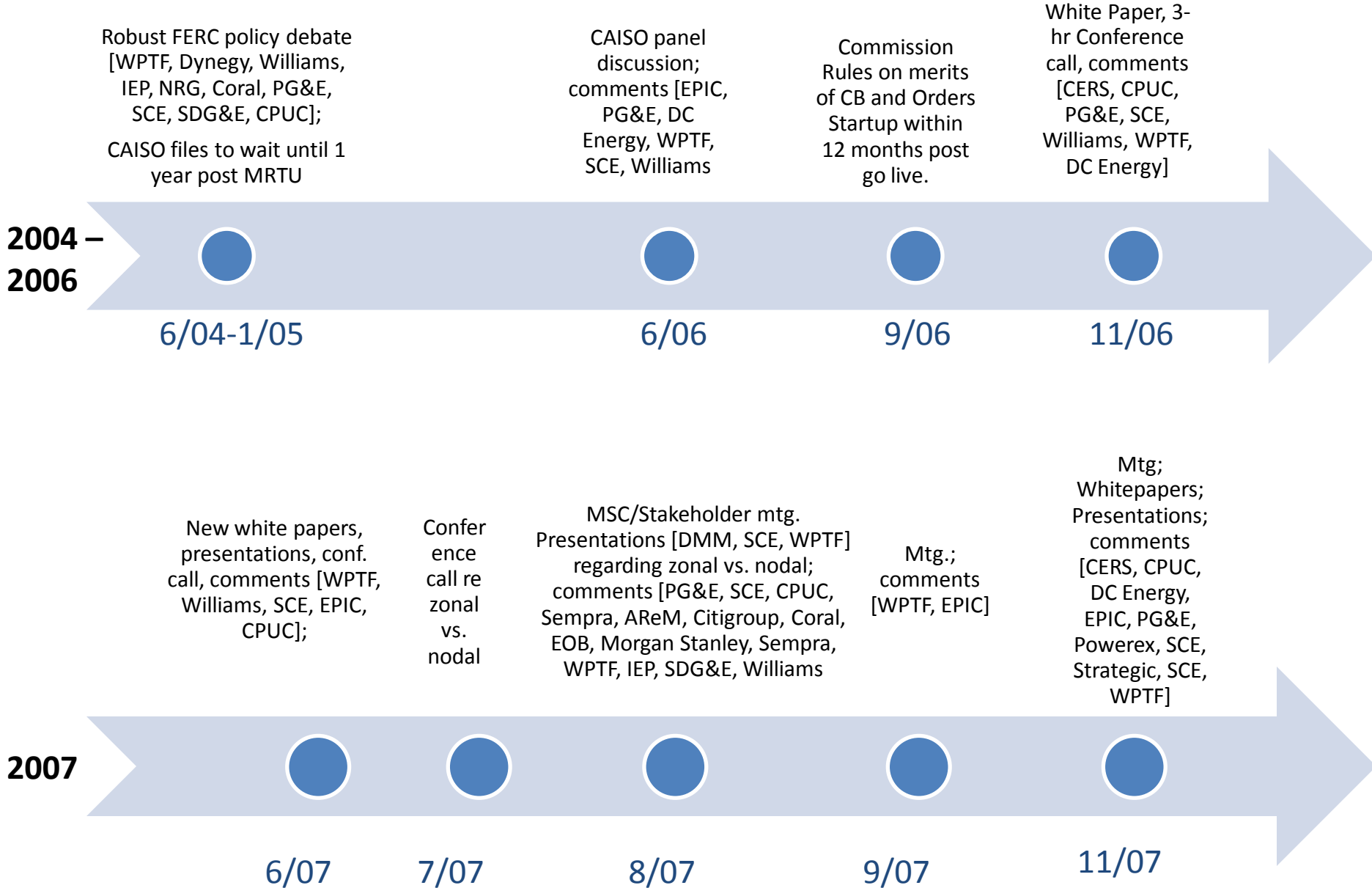
<sup>8</sup> Platt’s report of Nodal Trader Conference, November 13-14, 2008.

<sup>9</sup> Platt’s report of Nodal Trader Conference, November 13-14, 2008.

<sup>10</sup> MISO Independent Market Monitor (Report of the Midwest ISO Independent Market Monitor: July 2007, Presented 08/15/07 to the Market Committee of the Board of Directors, Slide 11)



# Convergence Bidding Stakeholder Process Historical Timeline (1 of 2)



# Convergence Bidding Stakeholder Process Historical Timeline (2 of 2)

MSC/Stakeholder mtg.; white paper; presentation; comments [CPUC, Dynegy, EPIC, PG&E, SCE, CDWR, WPTF]

Mtg. with ISO NE; presentations

Mtg. with MISO; Presentations

Mtg.; whitepapers; presentations; comments [CDWR, CPUC, Dynegy, EPIC, JP Morgan, PG&E, SCE, WPTF]

2008

2/08

5/08

7/08

10/08

Mtg.; whitepapers, presentations, comments [Calpine, CERS, Citigroup, CPUC, DMM, JP Morgan, PG&E, Powerex, WPTF, Western, SCE, EPIC]

2 Conference calls; whitepapers; presentations; comments [EPIC, PG&E, WPTF, SCE]

Conference call; MSC/Stakeholder mtg.; whitepaper; presentations;

2009

7/09

8/09

9/09