

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**California Independent System) Docket No. ER10-300-000
Operator Corporation)**

**ANSWER TO MOTIONS TO INTERVENE, REQUEST FOR TECHNICAL
CONFERENCE, AND COMMENTS, AND MOTION TO FILE ANSWER AND
ANSWER TO PROTESTS, OF THE CALIFORNIA INDEPENDENT
SYSTEM OPERATOR CORPORATION**

The California Independent System Operator Corporation (“ISO”)¹ hereby files its answer to the motions to intervene, request for a technical conference, comments, and protests submitted in this proceeding² in response to the ISO’s submittal on November 20, 2009 of its convergence bidding design (“Convergence Bidding Design Filing”) for Commission approval.³

¹ The ISO is also sometimes referred to as the CAISO. Capitalized terms not otherwise defined herein have the meanings set forth in Appendix A to the ISO tariff.

² The following entities filed motions to intervene, request for a technical conference, comments and protests: the California Department of Water Resources State Water Project (“SWP”); California Energy Resources Scheduling Division of the California Department of Water Resources (“CERS”); California Municipal Utilities Association; California Public Utilities Commission (“CPUC”); Calpine Corporation (“Calpine”); Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, “Six Cities”); Citigroup Energy Inc.; City of Santa Clara, California, d/b/a Silicon Valley Power (“SVP”); DC Energy, LLC (“DC Energy”); Dynegy Morro Bay, LLC, Dynegy Moss Landing, LLC, Dynegy Oakland, LLC, and Dynegy South Bay, LLC (collectively, “Dynegy”); Golden State Water Company; J.P. Morgan Ventures Energy Corporation and BE CA LLC (together, “J.P. Morgan”); Modesto Irrigation District; M-S-R Public Power Agency; Northern California Power Agency (“NCPA”); NRG Power Marketing LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, and Long Beach Generation LLC; Pacific Gas and Electric Company (“PG&E”); Powerex Corp. (“Powerex”); Sacramento Municipal Utility District; SESCO Enterprises, LLC, Jump Power, LLC, Silverado Energy LP, and JPTC, LLC (collectively, “Financial Marketers”); Southern California Edison Company (“SCE”); and Western Power Trading Forum (“WPTF”). In addition, the CPUC submitted a notion of intervention in the proceeding.

³ The ISO submits this answer pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213 (2009). The ISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to the protests. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the

The ISO does not oppose any of the motions to intervene. With the exception of one protest submitted by a few parties that did not participate in the convergence bidding stakeholder process, commenters in this proceeding express support for most elements of the ISO's convergence bidding design.⁴ Parties that seek modifications to the ISO's design proposal have not demonstrated that the ISO's design is not just and reasonable. For the reasons explained below, the Commission should accept the Convergence Bidding Design Filing as submitted and should reject parties' arguments that it should be modified or made subject to additional Commission procedures.

I. Answer

A. Many Parties Express Support for the Convergence Bidding Design.

A number of parties state that they generally support the proposals contained in the Convergence Bidding Design Filing.⁵ In addition, all commenters that were active participants in the convergence bidding stakeholder process uniformly express support for certain elements of the convergence

decision-making process, and help to ensure a complete and accurate record in this case. See, e.g., *Entergy Services, Inc.*, 116 FERC ¶ 61,286, at P 6 (2006); *Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,124, at P 11 (2006); *High Island Offshore System, L.L.C.*, 113 FERC ¶ 61,202, at P 8 (2005).

⁴ Convergence bidding is also known as virtual bidding. As was the case on the Convergence Bidding Design Filing, the terms "convergence" and "virtual" are used interchangeably in this filing. "Virtual" emphasizes the non-physical nature of the bids while "convergence" highlights one of the most significant expected benefits of this market feature – convergence of day-ahead and real-time prices. See Convergence Bidding Design Filing at 2 n.4.

⁵ See, e.g., PG&E at 3; Calpine at 1; DC Energy at 3; WPTF at 2; Dynegy at 2; J.P. Morgan at 5.

bidding design, including the use of nodal virtual bidding.⁶ However, parties raise issues regarding other elements of the convergence bidding design. Those issues are discussed below.⁷

Some parties that support the convergence bidding design suggest that the Commission can modify certain elements of the design without any adverse impact. For example, SCE states that the Commission's adoption of the changes that SCE proposes to certain elements of the ISO's proposed convergence bidding design, such as nodal virtual bidding at the interties, would not upset the balance achieved by the ISO and stakeholders regarding the package of changes contained in the ISO's filing.⁸ Other parties seek to eliminate key elements of the convergence bidding design, such as position limits. As the ISO explained in its filing, the Commission should accept the package of convergence bidding design changes proposed therein without modification or condition. The balance ultimately struck entails nodal, rather than zonal, virtual bidding – including nodal bidding at internal nodes and the interties – subject to position limits at internal nodes and interties. Commission acceptance would preserve

⁶ See, e.g., Calpine at 2; CERS at 4; DC Energy at 4-5; SWP at 6; WPTF at 3; J.P. Morgan at 6.

⁷ Some parties request that the Commission direct the ISO to implement convergence bidding sooner than the ISO's proposed date of February 1, 2011, or to file periodic reports on the progress being made towards the implementation of convergence bidding. See DC Energy at 12; Financial Marketers at 4; Powerex at 10. Those procedural requests are addressed in the answer that the ISO is filing in response to the answers submitted by parties in Docket Nos. ER06-615 and ER02-1656 regarding the ISO's motion for an extension of the time permitted to put convergence bidding into effect.

⁸ SCE at 2-4, 24-25.

the balance that the ISO and stakeholders have achieved through their lengthy and often contentious stakeholder process.⁹

B. The Commission Should Reject the Financial Marketers' Request for a Technical Conference.

The Financial Marketers, alone among the parties in this proceeding, request that the Commission order a technical conference to address issues related to the convergence bidding design.¹⁰ The Commission should reject this request. There is no need to hold a technical conference given that the convergence bidding policy issues have been thoroughly discussed during the years-long stakeholder process detailed by the ISO,¹¹ and any remaining policy issues are resolvable by the Commission based on the Convergence Bidding Design Filing, the pleadings submitted in response to that filing, this Answer, and the Commission's own review of the issues presented in those filings.

If the Financial Marketers had wanted to assist in the resolution of the convergence bidding policy issues before those issues were presented to the Commission, they should have taken an active part in the stakeholder process. However, the Financial Marketers chose to stay on the sidelines for years while other stakeholders and the ISO worked to develop the convergence bidding design policy. Only near the very end of that stakeholder process did the Financial Marketers opine on what the design policy should contain. As a review of the written comments filed in the stakeholder process shows, the *only* written

⁹ Convergence Bidding Design Filing at 5, 38.

¹⁰ Financial Marketers at 39-40.

¹¹ See Convergence Bidding Design Filing at 6-8 and Attachment E.

comments that the Financial Marketers (either together or individually) provided on any of the convergence bidding issues were comments submitted on October 2, 2009, which was the final opportunity for stakeholders to provide written comments.¹² The Financial Marketers were absent or silent during the numerous stakeholder conferences held over the years on the convergence bidding design policy. It would be unreasonable to grant the Financial Marketers' desire for a technical conference when for so long they could have done much – but refused to do anything – to contribute to the ISO's and the stakeholders' efforts to develop the very design which the Financial Marketers now protest.¹³ Indeed, if the Commission were to grant the requested technical conference, it would undermine the viability of the ISO's stakeholder processes, providing a model for other parties to raise issues at the last minute and delay a Commission decision on a package of market design elements developed over many years with the input of more diligent stakeholders.

C. The Commission Should Approve the Characteristics of Virtual Bids Proposed by the ISO.

1. One Megawatt Limit on Virtual Bids

The ISO proposes the requirement that each virtual bid be no smaller than one megawatt.¹⁴ Only the Financial Marketers oppose this requirement.¹⁵ While

¹² See <http://www.caiso.com/1807/1807996f7020.html>.

¹³ The Financial Marketers' efforts to dictate the elements of the convergence bidding design policy, after having contributed nothing to the development of the design policy for years, is a theme to which the ISO will return throughout this Answer.

¹⁴ Convergence Bidding Design Filing at 9-10.

¹⁵ Financial Marketers at 36-37.

most entities simply did not comment on the requirement, one commenter engaged in marketing activities – J.P. Morgan – supports this element of the ISO’s convergence bidding design.¹⁶ The Commission should accept the minimum virtual bid requirement as just and reasonable consistent with its acceptance of similar minimum virtual bid requirements for the New York Independent System Operator, Inc. (“New York ISO”) and ISO New England Inc. (“ISO New England”).¹⁷

2. Aggregation and De-aggregation of Convergence Bids in the ISO’s Software

In the Convergence Bidding Design Filing, the ISO explained that it plans to enhance the existing day-ahead market software to aggregate all of the virtual bids at each location to create one composite virtual bid curve for virtual supply and virtual demand, and later to de-aggregate the virtual bid results into individual cleared bid results and publish them.¹⁸ The Financial Marketers, which request that the ISO provide more details regarding that plan,¹⁹ fail to recognize that substantial details concerning that proposal are already available. The proposal was designed to address concerns about the ability of the ISO’s software to handle large bid volumes and was developed as an alternative to a bid volume proposal opposed by a number of market participants, as explained in the “Addendum to the Draft Final Proposal for the Design of Convergence

¹⁶ J.P. Morgan at 8.

¹⁷ See Convergence Bidding Design Filing at 32.

¹⁸ *Id.* at 10.

¹⁹ Financial Marketers at 37-38.

Bidding” (at 5-6) (“Addendum”).²⁰ Moreover, the proposal was discussed at stakeholder meetings and was widely supported as an alternative to limitations on convergence bidding activity. Finally, although the ISO discussed the proposal in the Convergence Bidding Design Filing, it is more appropriately characterized as implementation detail which should have no impact on the ability of market participants to submit virtual bids.²¹

D. The Commission Should Approve the Conditions Under Which the ISO Proposes to Allow Convergence Bidding at the Interties.

During the stakeholder process, a number of parties expressed concerns as to whether convergence bidding on the interties could be implemented in a manner that complies with reliability criteria and that would not have an adverse impact on California given the region’s reliance on imports to serve much of the demand for electricity. To address these concerns, the ISO developed specific design features to allow convergence bidding at the interties, which will include two main components: the addition of constraints within the ISO’s market software for scheduling at the interties, and position limits that are more stringent and longer-lasting than the position limits applicable to internal nodes.²²

²⁰ A copy of the Addendum can be found at <http://www.caiso.com/1807/1807996f7020.html>, as noted in the Convergence Bidding Design Filing at page 8, footnote 17.

²¹ Stakeholders interested in this issue and other implementation issues can participate in the ongoing convergence bidding implementation workshops and meetings.

²² Convergence Bidding Design Filing at 15-19. General issues concerning position limits are discussed in Section I.E of this Answer.

Most parties that commented on this subject support the implementation of convergence bidding at the interties.²³ While PG&E does not oppose it, PG&E does argue that convergence bidding at the interties should not be implemented until the ISO has sufficiently addressed three open issues regarding intertie convergence bidding that are discussed in the Addendum.²⁴ The ISO thoroughly discussed these issues during the stakeholder process and has responded to them in several ways.

First, with regard to enforcing the physical scheduling limits on the interties the ISO is currently conducting a stakeholder process to consider creating stronger incentives for parties to submit physical import and export bids into the IFM *only* when they actually intend to physically fulfill their IFM schedules in real-time. The intent of such incentives would be to enable the ISO to accurately distinguish between physical and virtual bids submitted to the IFM so that the physical scheduling limits are accurately enforced. Beyond that, the ISO believes that enforcing un-priced physical scheduling limits at the interties strikes the best possible balance between the west-wide requirement to observe these limits and the critical objective of creating a single locational marginal price (“LMP”) at each intertie that reflects the impact of all cleared physical and virtual bids. Second, with regard to price differences between the HASP and the real-time dispatch, the ISO has been investigating and addressing the root causes of

²³ See, e.g., DC Energy at 6; Powerex at 6-7.

²⁴ PG&E at 10-13. The three open issues are: (1) the potential unintended consequences of adding a constraint on physical intertie schedules that is not reflected in prices; (2) the need to resolve current discrepancies between hour-ahead scheduling process (“HASP”) and real-time dispatch prices; and (3) potential crowding out of physical imports by virtual imports in the integrated forward market (“IFM”). Addendum at 11-13.

such differences through its ongoing assessment of market performance. Third, with regard to potential crowding out of physical imports by virtual imports in the IFM, the imposition of lower position limits at the interties will substantially constrain the ability of any individual market participant to have a significant impact of this sort. In addition, the ISO notes that a strategy of offering low-priced virtual imports in the IFM to crowd out physical imports should generally be a money-losing strategy because the virtual bidder will face higher prices to buy back its imports in the HASP. The ISO therefore believes that closely monitoring the markets for this phenomenon, along with enforcing the lower position limits, are sufficient protections for the implementation of virtual bidding at the interties to proceed, and believes that these issues should not cause the Commission to delay its approval of the ISO's proposal.

Powerex and SCE request that the ISO expedite and report on its ongoing, separate stakeholder process to modify the time-line for the submission of electronic tags ("E-tags"), which includes discussion of possible means to differentiate between physical bids and convergence bids at the interties.²⁵ There is no need for the Commission to make the directives that Powerex and SCE request, because the entire stakeholder and approval process for the E-tag initiative is expected to be completed in the first quarter of 2010. As explained in a presentation given to stakeholders on December 14 regarding the E-tag stakeholder process, the ISO plans to issue a draft final proposal for stakeholder review on January 7, 2010, hold a last stakeholder conference call on January

²⁵ Powerex at 8-9; SCE at 6-8.

14, review final written stakeholder comments submitted by January 21, and obtain any necessary approval required for the final E-tag proposal at the February 11 meeting of the ISO Governing Board.²⁶

E. The Commission Should Accept the ISO's Proposal to Apply Position Limits to Virtual Bids at Internal Nodes and Interties.

The ISO, in the Convergence Bidding Design Filing, proposed to apply position limits on the megawatt volume of convergence bids that a scheduling coordinator can submit on behalf of a convergence bidder at an individual internal node or intertie, in order to mitigate the potential exercise of market power. To provide a controlled transition to nodal virtual bidding, the ISO also made specific proposals for phasing out the position limits at specified percentage levels over time.²⁷ As discussed below, the adoption of position limits was a key element in obtaining widespread stakeholder support across various classes of market participants for convergence bidding on a nodal basis, rather than a zonal basis. This was a critical breakthrough that broke the stalemate concerning whether the ISO would implement nodal or zonal convergence bidding. The ISO's Market Surveillance Committee ("MSC") and Department of Market Monitoring ("DMM") both support the use of position limits.

Although a number of parties state that they support the use of position limits,²⁸ other parties argue that the Commission should not permit the ISO to

²⁶ See ISO presentation entitled "E-tag Timing Requirements" (Dec. 14, 2009), at slide 7. The presentation is available on the ISO's website at <http://www.caiso.com/2480/2480d32b21550.pdf>. The ISO maintains a website page devoted to the E-tag stakeholder process at <http://www.caiso.com/244c/244cabfb36550.html>,

²⁷ Convergence Bidding Design Filing at 12-15, 19.

²⁸ See, e.g., CPUC at 4; NCPA at 5; PG&E at 7; SCE at 5-6.

adopt any position limits.²⁹ Some parties that support position limits argue that the ISO should be required to phase them out at different percentage levels or on different timetables than the ISO proposes, or should phase them out pursuant to no predetermined percentage levels or timetables at all.³⁰ The Commission should accept the ISO's position limits proposal without modification for the reasons explained below.

Some parties that oppose position limits claim that they are unnecessary and may even be harmful to the development of the convergence bidding market, and that other independent system operators ("ISOs") and regional transmission organizations ("RTOs") with virtual bidding do not employ position limits. These parties fail to recognize that, while the ISO recognizes the benefits of a nodal virtual bidding design, the ISO also believes that it is prudent to adopt a controlled transition to nodal virtual bidding that mitigates the risk of market power that could exist in the absence of a deep and liquid virtual bidding market.

Before the position limits were integrated into the ISO's convergence bidding design, some stakeholders supported nodal convergence bidding and others took the opposite view that convergence bidding should be conducted only at the three large load aggregation points ("LAPs") in the ISO balancing authority area in order to simplify the design and to minimize the risk that market power could be exercised through convergence bidding. The MSC then suggested that the ISO adopt position limits as a means of addressing the

²⁹ Only energy suppliers and marketers made this argument. See, e.g., Calpine at 2-4; Financial Marketers at 9-12; WPTF at 7-9.

³⁰ See, e.g., NCPA at 5-6; PG&E at 8-9; SCE at 6.

concerns that stakeholders favoring a LAP-based design had about the potential for the exercise of market power under a nodal design. The DMM also recommended the use of position limits. Based on the input provided by the MSC, the DMM, and stakeholders, as well as the ISO's own analysis, the ISO determined that it should propose convergence bidding on a nodal basis, subject to position limits that would mitigate the potential exercise of market power by market participants that could occur absent a deep and liquid market for convergence bidding at the initial implementation of convergence bidding.³¹

The ISO believes that including the position limits proposal was necessary and appropriate to address the potential exercise of market power and to obtain widespread stakeholder support for the use of a nodal rather than a LAP-based (*i.e.*, zonal) convergence bidding design. As explained above, parties in this proceeding have expressed unanimous support for the use of nodal convergence bidding.³² Stakeholders in California have unique concerns about the potential for new design elements to create opportunities for market manipulation based, in part, on the state's experiences in the Western energy crisis of 2000-2001.

In addition, it is beside the point that other ISOs and RTOs do not have position limits in their market designs. The other ISOs and RTOs have not experienced market manipulation and market power issues that are as severe as those experienced during the energy crisis of 2000-2001. Moreover, as the Commission has recognized, there are a wide range of utility practices which can

³¹ Convergence Bidding Design Filing at 10, 12-13.

³² See *supra* note 6 and accompanying text.

be just and reasonable. The ISO believes that a convergence bidding design with position limits in the initial years is not only a just and reasonable design but also is an appropriate design given the historic concerns about the potential for market manipulation in California. In these circumstances, the Commission should find that the proposed position limits are just and reasonable because they will serve to mitigate the potential exercise of market power and their inclusion in the convergence bidding design was the only feasible means of balancing different stakeholder interests.³³

The parties that argue that any position limits the Commission approves should be phased out based on different percentage levels and timetables than the ISO proposes, or based on percentage levels and timetables that are not predetermined, have differing views on those matters. Some of those parties favor increasing the percentage levels and shortening the timetables for lifting position limits³⁴ and others support doing the opposite.³⁵ Despite the claims of each of these parties that its position limit proposal – not the ISO’s – is the superior one, the proper legal standard is whether the ISO’s proposal is just and

³³ See, e.g., *ISO New England Inc.*, 126 FERC ¶ 61,080, at P 17 (2009) (finding that proposed tariff revisions are just and reasonable, are the result of a comprehensive stakeholder process, and balance competing interests of market participants); *California Independent System Operator Corp.*, 126 ¶ 61,285, at P 36 (2009) (same).

³⁴ See, e.g., *Calpine* at 4 (asserting that any position limits the Commission approves should be set no lower than 50 percent and should be phased out within one year); *WPTF* at 8-9 (asserting that the ISO should relax its proposed position limits at the interties).

³⁵ See, e.g., *Six Cities* at 2-3 (asserting that the schedule for relaxation of the position limits proposed by the ISO should be the minimum periods of time for the application of the indicated position limits); *SCE* at 6 (asserting that some level of position limits may need to be a permanent feature of the market).

reasonable under Section 205 of the Federal Power Act (“FPA”).³⁶ Specifically, as the Commission has explained, “the courts and this Commission have recognized that there is not a single just and reasonable rate. Instead, we evaluate [proposals under Section 205] to determine whether they fall into a zone of reasonableness. So long as the end result is just and reasonable, the [proposal] will satisfy the statutory standard.”³⁷ The ISO’s proposed percentage levels and timetables for position limits fall well within the zone of reasonableness, because they strike a reasonable balance between the need to guard against the potential exercise of market power while still permitting a large number of megawatt-hours of virtual bids to be submitted at the internal nodes and interties by many market participants independently of one another.³⁸ Therefore, the Commission should accept the ISO’s proposal.

Some of the parties that oppose predetermined timetables for lifting the position limits argue that the ISO should be required to obtain the approval of the MSC and/or the DMM before it can change the position limits.³⁹ The ISO opposes this proposed requirement. Moreover, there is no need for the ISO to obtain such approval. Prior to each of the ISO’s proposed dates for changes in

³⁶ 16 U.S.C. § 824d. Under Section 15 of the ISO tariff, the ISO is the entity authorized to submit filings for Commission approval pursuant to Section 205 of the FPA.

³⁷ *Calpine Corp. v. California Independent System Operator Corp.*, 128 FERC ¶ 61,271, at P 41 (2009) (citations omitted). See also *New England Power Co.*, 52 FERC ¶ 61,090, at 61,336 (1990), *aff’d*, *Town of Norwood v. FERC*, 962 F.2d 20 (D.C. Cir. 1992) (rate design proposed need not be perfect, it merely needs to be just and reasonable), *citing Cities of Bethany, et al. v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir.), *cert. denied*, 469 U.S. 917 (1984) (utility needs to establish that its proposed rate design is reasonable, not that it is superior to all alternatives).

³⁸ Convergence Bidding Design Filing at 14.

³⁹ See, e.g., NCPA at 5-6; SCE at 6.

position limits, the ISO will consult with the MSC and DMM. If, based on the input provided by the MSC and DMM and on its own analysis, the ISO concludes that it is not appropriate for the ISO to make the position limits change reflected in the ISO's proposal, the ISO will timely make a filing with the Commission to modify the percentage level and/or timetable for the upcoming change.

F. The Commission Should Accept the Features of the ISO's Design for Convergence Bidding That Address the Potential for Market Power and Market Manipulation.

The ISO, in the Convergence Bidding Design Filing, acknowledged that the implementation of convergence bidding may increase opportunities for market participants to exercise market power or engage in market manipulation. To address those concerns, the ISO proposed not only the position limits discussed above, but other safeguards as well.⁴⁰

1. Application of the ISO's Existing Local Market Power Mitigation Procedures

The ISO, in the Convergence Bidding Design Filing, proposed to continue to apply its existing local market power mitigation and reliability requirements ("LMPM") procedures when convergence bidding is implemented.⁴¹ Several parties express their support for the ISO's proposal.⁴² However, the Financial Marketers argue that, by continuing to apply its existing LMPM procedures, the ISO will be acting inconsistently with directives contained in a Commission order

⁴⁰ Convergence Bidding Design Filing at 19-20.

⁴¹ *Id.* at 20-21.

⁴² DC Energy at 7; J.P. Morgan at 16; WPTF at 4; Six Cities at 2.

issued in April 2007.⁴³ There is no inconsistency between the ISO's proposed actions and the directives in the April 2007 Order. As the ISO explained in the Convergence Bidding Design Filing, the April 2007 Order directed the ISO to use bid-in demand rather than forecasted demand in the market power mitigation-reliability requirements determination ("MPM-RRD") run within three years of start-up of the ISO's new market.⁴⁴ Because the ISO's new market went into effect on March 31, 2009 for the day-ahead market for the April 1, 2009 trading day,⁴⁵ the ISO is not required to use bid-in demand in the MPM-RRD run until April 2012. In contrast, convergence bidding is scheduled to be implemented more than a year before then, on February 1, 2011. Therefore, it is entirely consistent with the April 2007 Order for the ISO not to use bid-in demand in the MPM-RRD run prior to April 2012. The existing LMPM process that includes only physical supply and uses the ISO load forecast in the MPM-RRD adequately addresses concerns raised by the DMM and market participants that virtual supply could undermine the LMPM process.

The ISO also noted in the Convergence Bidding Design Filing that, in October 2009, the DMM had set forth a possible approach (called "Option B") to local market power mitigation for convergence bidding that the DMM stated "merits further consideration as a further modification of LMPM procedures, particularly as an option for complying with the Commission's directive" in the

⁴³ Financial Marketers at 32 (citing *California Independent System Operator Corp.*, 119 FERC ¶ 61,076 (2007) ("April 2007 Order")).

⁴⁴ Convergence Bidding Design Filing at 20 (citing April 2007 Order at PP 496, 662).

⁴⁵ Convergence Bidding Design Filing at 5 n.7.

April 2007 Order,⁴⁶ and that the MSC indicated that Option B “is worthy of further study for possible implementation at a future date.”⁴⁷ Some parties now argue that the Commission should direct the ISO to implement Option B for the initial implementation of convergence bidding.⁴⁸ Although the ISO agrees with the MSC that Option B is worthy of study for possible future implementation, the parties’ requests should be rejected.

Implementing an Option B-type approach to LMPM for the initial implementation of convergence bidding could result in a delay to the convergence bidding implementation schedule, particularly due to the need to redesign the LMPM process to use separate bid curves (market bids versus default energy bids) in the competitive constraints run versus the all constraints run, which is the root of the solution proposed under Option B.⁴⁹ The ISO plans to evaluate possible enhancements to the LMPM process, including Option B, to satisfy the Commission’s directive in the April 2007 Order.⁵⁰ However, the details of such possible enhancements have not yet been vetted by the ISO and stakeholders. The ISO will initiate a stakeholder process to evaluate possible approaches, and, after opportunity for stakeholder review and comment, the ISO

⁴⁶ Convergence Bidding Design Filing at 20-21 (quoting DMM white paper entitled “Local Market Power Mitigation Options Under Convergence Bidding” (Oct. 2, 2009) (“LMPM White Paper”).

⁴⁷ Convergence Bidding Design Filing at 20-21 & n.40 (quoting DMM white paper entitled “Local Market Power Mitigation Options Under Convergence Bidding” (Oct. 2, 2009) (“LMPM White Paper”) and “Final Opinion of the Market Surveillance Committee of the California ISO” (Oct. 19, 2009) at 4 n.2).

⁴⁸ PG&E at 4-6; SCE at 20-21; SWP at 8-10.

⁴⁹ See LMPM White Paper at 5-6.

⁵⁰ Convergence Bidding Design Filing at 21.

plans to prepare and submit for Commission approval a proposal for timely meeting the requirements of the April 2007 Order. That stakeholder process should not be short-circuited by a premature requirement to implement Option B.

2. CRR Settlement Rule

In the Convergence Bidding Design Filing, the ISO proposed a four-step, automated congestion revenue right (“CRR”) settlement rule to address the well-documented market manipulation concern that convergence bids can be used to alter the value of CRRs. The ISO described the CRR settlement rule and explained that it is detailed further in Appendix B to the Addendum.⁵¹ The parties that commented on the issue all express general support for the CRR settlement rule,⁵² with the exception that the Financial Marketers argue that it should be rejected.⁵³

The Financial Marketers assert that the Commission should find that the proposed CRR settlement rule is unjust and unreasonable. That contention ignores the fact that both PJM Interconnection, L.L.C. (“PJM”) and ISO New England have similar, Commission-approved settlement rules in their tariffs to address the potential for market manipulation.⁵⁴ The Financial Marketers also complain that the ISO does not sufficiently explain the rationale for and

⁵¹ *Id.* at 21-22.

⁵² See CERS at 5; J.P. Morgan at 11-13; WPTF at 4-5.

⁵³ Financial Marketers at 32-34.

⁵⁴ Convergence Bidding Design Filing at 21; Appendix B to Addendum at 1; DMM paper entitled “Congestion Revenue Rights Settlement Rule” (Aug. 18, 2009), which is cited in Appendix B to the Addendum at 1 n.1; PJM Open Access Transmission Tariff, Attachment K – Appendix, Sections 5.2.1(b) and -(c); ISO New England Transmission, Markets and Services Tariff, Market Rule 1, Section III.A.8.4.

components of its proposed CRR settlement rule (e.g., the Financial Marketers assert that the ISO does not explain what constitutes a significant impact on a constraint under step two of the CRR settlement rule). The ISO has provided a full explanation of the proposed settlement rule in the Convergence Bidding Design Filing as well as in other material available to stakeholders, including Appendix B to the Addendum, the materials cited in Appendix B to the Addendum, and the draft external business specification for convergence bidding posted on the ISO's website devoted to the convergence bidding stakeholder process.⁵⁵ These documents provide the details the Financial Marketers request. For example, pages 3-4 of Appendix B to the Addendum detail what constitutes a significant impact on a constraint, under the following heading: "*Step 2. Determine hours where participant's portfolio of virtual bids significantly impacted constraint*" (emphasis in original).

For these reasons, the Commission should find that the Financial Marketers' arguments are without merit and should accept the ISO's CRR settlement rule.

3. ISO Authority to Limit or Suspend Convergence Bidding

In the Convergence Bidding Design Filing, the ISO requested that, pursuant to recommendations from the DMM, the Commission grant the ISO the authority to quickly respond to any problems that may occur under nodal convergence bidding by limiting or suspending convergence bidding by market

⁵⁵ See External Business Requirements Specification – Convergence Bidding, Version 1.0 (Dec. 1, 2009), at <http://www.caiso.com/2478/24788f756dfc0.pdf>.

participants.⁵⁶ While the parties that commented on the issue generally express support for the principle that the ISO should have authority to limit or suspend convergence bidding, a number of those parties argue that the ISO should explain its requested authority with more specificity and that the Commission should not accept the design element related to the ISO's suspension authority until it has reviewed the proposed tariff language to implement the proposal.⁵⁷ The ISO has provided the Commission with enough information about the specifics of the proposal to enable the Commission to find that the proposal is just and reasonable.⁵⁸ The Commission has approved bidding suspension authority for the New York ISO and the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO").⁵⁹ The detail that the ISO has already provided to the Commission concerning the proposed suspension authority is comparable to the detail in the New York ISO and Midwest ISO tariffs.

The Financial Marketers are the only parties that argue that the Commission should reject the ISO's proposal for authority to limit or suspend

⁵⁶ Convergence Bidding Design Filing at 22-23. Such suspension could apply to any market participant or group of market participants that is found to: (1) detrimentally affect grid or market operations, (2) contribute to an unwarranted divergence in prices in the IFM and real-time market, or (3) otherwise distort competitive market outcomes. *Id.* at 22.

⁵⁷ See, e.g., Dynegy at 4-5; J.P. Morgan at 13-14; SWP at 7.

⁵⁸ See Convergence Bidding Design Filing at 22-23; "Convergence Bidding: Department of Market Monitoring Recommendations" at 13-15 (DMM document cited in Convergence Bidding Design Filing at 22 n.43); "Draft Final Proposal for the Design of Convergence Bidding" (Sept. 14, 2009) at 17-19 ("Draft Final Proposal"). A copy of the Draft Final Proposal can be found on the ISO's website at <http://www.caiso.com/1807/1807996f7020.html>, as noted in the Convergence Bidding Design Filing at page 8, footnote 16.

⁵⁹ See New York ISO Market Administration and Control Area Services Tariff, Section 5.2(B), and Midwest ISO Open Access Transmission, Energy and Operating Reserve Markets Tariff, Section 65.5.3.

convergence bidding, in part on the grounds that the proposal is not sufficiently specific.⁶⁰ Again, the ISO has provided enough specific details and the Commission should grant the ISO the proposed authority for the reasons explained in the ISO's supporting documentation.⁶¹ The Financial Marketers also argue that the ISO's proposal is too severe in permitting a suspension of convergence bidding for up to 100 days.⁶² As noted above, the Midwest ISO has tariff provisions that authorize it to restrict virtual bidding by market participants for a comparable period of three months. Further, pursuant to the Convergence Bidding Design Filing, the ISO will be required to file supporting documentation with the Commission within 10 business days of enforcing a limitation or suspension regarding convergence bidding, and that limitation or suspension will remain in effect for 90 calendar days after the ISO submits its initial filing *unless*: (a) the Commission directs otherwise, or (b) the ISO determines that the limitation or suspension is no longer needed.⁶³ Thus, the Commission or the ISO will be able to lift the limitation or suspension in far fewer than 100 days if warranted.

The Financial Marketers point out that the Convergence Bidding Design Filing does not state that the ISO will consult with affected market participants before limiting or suspending their ability to engage in convergence bidding.⁶⁴

⁶⁰ Financial Marketers at 34-35.

⁶¹ See *supra* note 59.

⁶² Financial Marketers at 35.

⁶³ Convergence Bidding Design Filing at 23.

⁶⁴ Financial Marketers at 35.

The ISO does in fact propose to consult with affected market participants beforehand to the extent such consultation is feasible, though that component of the ISO's proposal was explained in the supporting documentation rather than in the Convergence Bidding Design Filing itself.⁶⁵

G. The ISO Has Already Provided Sufficient Detail Regarding the Possible Use of Megawatt Limits to Ensure an AC Solution.

The ISO, in the Convergence Bidding Design Filing, explained that it will continue to achieve an alternating-current ("AC") solution with the inclusion of virtual bids to the greatest extent practicable, and, in order to increase the likelihood of achieving an AC solution with convergence bidding, the ISO plans to include in its software the capability of enforcing megawatt constraints on a locational basis to limit the amount of bids that clear at a particular location or set of locations.⁶⁶ Several parties express concerns about the ISO's ability to perform those tasks successfully and request that the ISO be required to prepare and submit filings (e.g., status reports) to the Commission regarding the AC solution.⁶⁷

The Commission should deny the request for separate status reports on the AC solution issue. PJM already applies location-based megawatt limits as necessary to achieve an AC solution,⁶⁸ and the ISO has no reason to believe it

⁶⁵ "As part of the ISO's determination to limit or suspend a participant's ability to engage in Virtual Bids at specific nodes, the ISO would request explanation of the relevant bidding practices." Draft Final Proposal at 18.

⁶⁶ Convergence Bidding Design Filing at 24-25.

⁶⁷ See, e.g., NCPA at 6; PG&E at 16-18; SCE at 4-5.

⁶⁸ Convergence Bidding Design Filing at 32.

will be unable to do the same. The ISO expects to resolve this concern in the course of the software testing for convergence bidding. If the ISO identifies an AC solution issue during software testing, it will discuss the issue with stakeholders and evaluate how best to proceed based on the software testing data.

The Commission should also deny the request of SVP (at 6) that the ISO be required to include in the ISO tariff details on the ISO's enforcement of location-specific megawatt limits. The Convergence Bidding Design Filing already contains sufficient detail on the purpose of the megawatt limits – namely, to ensure an AC solution – and the ISO is currently conducting its stakeholder process to address the level of detail to be included in the tariff amendment to implement convergence bidding. Tariff drafting issues such as those raised by SVP are beyond the scope of the instant proceeding.

H. The Commission Should Accept the ISO's Proposed Convergence Bidding Certification Requirements.

In the Convergence Bidding Design Filing, the ISO explained that it proposes to require virtual bidders to meet certain certification requirements to be specified in the ISO tariff and the Business Practice Manuals in order to participate in the ISO's markets.⁶⁹ WPTF supports the ISO's convergence bidding certification requirements.⁷⁰ The only other party that addresses the subject, the Financial Marketers, argue that the ISO fails to justify the requirement that each convergence bidder either be a scheduling coordinator or

⁶⁹ *Id.* at 25.

⁷⁰ WPTF at 5-6.

be represented by one.⁷¹ In making this argument, the Financial Marketers overlook the fact that a fundamental element of the ISO's markets is that entities submitting bids in the ISO's energy markets must interact with the ISO via a scheduling coordinator. This has been the case since the ISO began operations in 1998.⁷² Since it has always been true of physical energy transactions, it should likewise be true of virtual energy transactions.

I. The Commission Should Accept the ISO's Proposed Credit Policy for Convergence Bidding.

The ISO, in the Convergence Bidding Design Filing, proposed to modify its credit policy to ensure sufficient credit coverage for virtual bids. Those proposed modifications support the two competing goals the ISO must balance in its credit policy: (1) ensuring that market participants are creditworthy or post sufficient collateral to support their convergence bids, in order to avoid exposing other market participants to financial risk, and (2) not discouraging convergence bidding and the benefits it will provide.⁷³

⁷¹ Financial Marketers at 38.

⁷² See, e.g., *San Diego Gas & Electric Co.*, 101 FERC ¶ 61,219, at P 113 (2002) ("the Commission simply recognized that all market interaction by the ISO is with Scheduling Coordinators"); *San Diego Gas & Electric Co.*, 100 FERC ¶ 63,018, at P 260 (2002) ("the ISO notes that its relationship in the wholesale electric market is with Scheduling Coordinators who represent various entities"); *California Independent System Operator Corp.*, 82 FERC ¶ 61,312, at 62,238 (1998) ("According to the ISO, it is not structured to deal with any entity other than through a Scheduling Coordinator with whom it has a contractual relationship, lines of communication, and mechanisms to bill and collect payment for use of service."). While it is true that the ISO has some market interactions directly with certain market participants, such as CRR holders (see ISO tariff, Section 36), those interactions do not concern the energy markets.

⁷³ Convergence Bidding Design Filing at 25-29.

Both DC Energy and WPTF state that they support the ISO's proposed credit policy for convergence bidding.⁷⁴ Only the Financial Marketers express disagreement with the credit policy. They argue that the ISO should use the 50th percentile value of the historical price difference between the day-ahead and real-time markets in setting credit policy reference prices, rather than the 95th percentile value the ISO proposes.⁷⁵ The Commission should reject the Financial Marketers' argument. While it is true that the Midwest ISO uses a 50th percentile value for its reference price, that is not the only just and reasonable percentile value that the Commission permits an ISO or RTO to employ. In the context of the ISO's own markets and credit policies, the ISO believes that adopting a 50th percentile reference price value would not provide sufficient credit coverage for virtual bids in markets that may be volatile (at least initially) and would expose the majority of market participants to the financial risk associated with virtual bidding. Also, as explained in the Convergence Bidding Design Filing, the Commission accepted the use of a 97th percentile reference price value for both PJM and the New York ISO.⁷⁶ Thus, the use of a 95th percentile value is easily within the zone of reasonableness as recognized by prior Commission orders.⁷⁷

⁷⁴ DC Energy at 8; WPTF at 5.

⁷⁵ Financial Marketers at 27-31.

⁷⁶ Convergence Bidding Design Filing at 28 & n.57.

⁷⁷ See *supra* note 37 and accompanying text. The Financial Marketers acknowledge that the New York ISO employs a 97th percentile reference price value but attempt to explain that inconvenient fact away by arguing that "virtual trading in the NYISO is so limited that it is not representative." Financial Marketers at 30 n.40. The Financial Marketers provide no support for the quoted statement, but even if it were accurate, that would not undermine the Commission's

The Financial Marketers also request that the Commission eliminate what they call the ISO's "90 percent trigger," which they state would "require more collateral as soon as a convergence bidder's estimated aggregate liability surpasses 90 percent of its aggregate credit limit."⁷⁸ The Commission should reject the Financial Marketers' request. The language that the Financial Marketers refer to is a provision in Section 12.4 of the ISO tariff which states that the ISO will "notify a Market Participant if at any time its Estimated Aggregate Liability exceeds ninety percent (90%) of its Aggregate Credit Limit." This is not a new proposal in the Convergence Bidding Design Filing. It is an existing provision that has been in the Commission-approved ISO tariff for years. Therefore, it is procedurally inappropriate for the Financial Marketers, in the context of the Convergence Bidding Design Filing which was submitted pursuant to Section 205 of the FPA, to request that the Commission eliminate that tariff provision. If the provision were to be deleted, that could only be done pursuant to a new proceeding established under Section 206 of the FPA.⁷⁹

The Financial Marketers also request that the Commission direct the ISO to use the lesser of the reference price or the bid price to value virtual demand bids.⁸⁰ There is no merit to this request because the reference price and the bid price are completely unrelated to one another. The reference price is a

finding that the New York ISO's use of a 97th percentile reference price value is just and reasonable. The Financial Marketers fail even to mention PJM's use of a 97th percentile reference price value, which the Commission likewise approved.

⁷⁸ Financial Marketers at 28.

⁷⁹ 16 U.S.C. 824e.

⁸⁰ Financial Marketers at 31.

percentile value of the price difference between the day-ahead and real-time markets which serves as a proxy for a settlement value of a virtual bid until day-ahead and real-time prices are available.⁸¹ The bid price is just that – a price based on bids. It does not make sense to compare the reference price to the bid price for purposes of valuing virtual demand bids.

J. The Commission Should Accept the ISO’s Proposals for Assessing Charges Related to Convergence Bidding.

1. Convergence Bidding Charge

In the Convergence Bidding Design Filing, the ISO proposed to create a new service charge for convergence bidding, called the convergence bidding charge, pursuant to discussions in the stakeholder process that revealed that market participants desired the ISO’s grid management charge (“GMC”) for virtual bids to be a set dollar per megawatt-hour charge that could be easily incorporated into their bidding strategies.⁸² While DC Energy and WPTF express provisional support for the adoption of a convergence bidding charge, subject to final determination of the level of that charge,⁸³ the Financial Marketers oppose the charge entirely.⁸⁴

The Commission should find that it is just and reasonable for the ISO to adopt a convergence bidding charge, for which the exact rate will be established in the 2011 GMC extension stakeholder process that will begin in January

⁸¹ See Convergence Bidding Design Filing at 26-27.

⁸² *Id.* at 30.

⁸³ DC Energy at 8; WPTF at 10-11.

⁸⁴ Financial Marketers at 13-16.

2010.⁸⁵ Although the rate has not yet been determined, the ISO estimates that the rate will be between \$0.065 and \$0.085 per cleared gross megawatt-hour, which is in the zone of reasonableness with the administrative fees for virtual bidding that other ISOs and RTOs assess.⁸⁶ In this regard, the Financial Marketers assert that the comparison with the administrative fees of other ISOs and RTOs is not valid, because those ISOs and RTOs apply their administrative fees to each cleared bid, whereas the CAISO proposes to apply the convergence bidding charge to each cleared gross megawatt-hour.⁸⁷ The Financial Marketers are incorrect. Subsequent to the submittal of the Convergence Bidding Design Filing, the Commission accepted the New York ISO's proposed administrative fee of \$0.065 per cleared virtual bid megawatt-hour.⁸⁸ The New York ISO correctly explained in its filing that, "[f]or PJM, the 2009 rate was \$0.045 per cleared virtual bid MWh and for the Midwest ISO the average monthly rate from July of 2008 through July of 2009 was \$0.085 per cleared virtual bid MWh."⁸⁹ Therefore, the Financial Marketers' argument is without merit.

⁸⁵ See Convergence Bidding Design Filing at 30.

⁸⁶ See *id.* at 32. See also *supra* note 37 and accompanying text.

⁸⁷ Financial Marketers at 14-15.

⁸⁸ See Commission Letter Order, Docket No. ER10-95-000 (Dec. 2, 2009); New York ISO's "Proposed Tariff Revisions to Allocate a Portion of Rate Schedule 1 Charges to Non-Physical Market Transactions, to Special Case Resources, and to Emergency Demand Response Program Participants and Request for Shortened Comment Period and for Expedited Action," Docket No. ER10-95-000 (Oct. 23, 2009), Transmittal Letter at 7.

⁸⁹ *Id.* The ISO regrets any confusion it may have caused by not including this detail about PJM and the Midwest ISO in the Convergence Bidding Design Filing.

2. Application of Existing Settlements, Metering, and Client Relations Charge to Scheduling Coordinators that Solely Represent Virtual Bidders

The Financial Marketers object to the assessment of what they call the ISO's "proposed" settlements, metering, and client relations charge.⁹⁰ Their objection reflects a lack of understanding of what the ISO is actually proposing. The ISO tariff *already* contains the settlements, metering, and client relations charge, which is assessed at a rate of \$1,000 per month, per scheduling coordinator identification code ("SCID") with an invoice value other than zero dollars in the current trading month.⁹¹ In the Convergence Bidding Design Filing, the ISO merely proposed to extend the application of that same charge to scheduling coordinators that only represent virtual bidders.⁹² This is a reasonable ISO proposal given that all scheduling coordinators (including those that only engage in inter-scheduling coordinator trades) are currently subject to the charge and all virtual bidders will be represented by scheduling coordinators.⁹³ Therefore, the Commission should reject the Financial Marketers' arguments on the issue.

3. Transaction Fees for Submitted Virtual Bids

The ISO, in the Convergence Bidding Design Filing, proposed to assess a transaction fee of \$0.005 per submitted virtual bid segment as a safeguard against "bid fishing," *i.e.*, the practice of submitting large numbers of bid

⁹⁰ Financial Marketers at 16-17.

⁹¹ ISO tariff, Section 11.22.2.5.8.

⁹² Convergence Bidding Design Filing at 30.

⁹³ See Section I.I, above.

segments that are likely to be uneconomic, which practice, if left unchecked, could lead to potential software performance issues.⁹⁴ The Financial Marketers and SVP argue that the ISO has not provided sufficient justification for that transaction fee.⁹⁵ Those arguments ignore the fact the PJM, the New York ISO, and ISO New England all assess similar transaction fees to virtual bidders, and the level of the CAISO's proposed transaction fee is less than or equal to the levels of the Commission-approved fees that those other ISOs and RTOs employ.⁹⁶ Moreover, in approving ISO New England's transaction fee, which is set at exactly the same level as the CAISO's, the Commission found that the fee is a "nominal charge . . . which will discourage frivolous bidding and allow the virtual traders to pay their fair share of ISO-NE's expenses since they benefit from the existence of ISO-NE's market infrastructure."⁹⁷ The Commission should make a similar finding regarding the CAISO's proposed fee to submit virtual bids in the California markets.

K. The Commission Should Accept the ISO's Proposed Allocation of Cost Uplifts to Convergence Bidders.

1. Allocation of IFM and RUC Cost Uplifts

The ISO, in the Convergence Bidding Design Filing, proposed methodologies for allocating IFM cost uplifts to net virtual demand positions related to the increased unit commitment in the IFM caused by virtual bidding,

⁹⁴ Convergence Bidding Design Filing at 31.

⁹⁵ Financial Marketers at 17-18; SVP at 6.

⁹⁶ Convergence Bidding Design Filing at 31-32.

⁹⁷ *ISO New England, Inc.*, 106 FERC ¶ 61,294, at P 30 (2004).

and for allocating residual unit commitment (“RUC”) cost uplifts to net virtual supply positions related to the increased unit commitment within RUC of the day-ahead market caused by virtual bidding. Following extensive discussion with stakeholders holding divergent views on how IFM and RUC cost uplifts should be allocated, the ISO crafted its proposed methodologies to adhere to cost causation principles, be fair and reasonable for all market participants, and be administratively workable for the ISO.⁹⁸

Given the different views on IFM and RUC cost uplift allocation expressed in the stakeholder process, it is not surprising that parties in this proceeding disagree with one another as to the merits of the ISO’s proposal for allocating cost uplifts. While some parties support the ISO’s proposal in its entirety,⁹⁹ others object to it on grounds that often reflect those parties’ diametrically opposed views of the economic rationales for such uplift charges.¹⁰⁰ For example, whereas the Financial Marketers argue that any IFM and RUC cost uplift allocation to convergence bidders should include netting but that the netting component of the ISO’s proposal does not go far enough, SCE takes the view that the Commission should reject the use of netting entirely in allocating these uplift charges to convergence bidders.¹⁰¹ The Financial Marketers also argue that the ISO’s proposal will require virtual supply and demand to subsidize

⁹⁸ Convergence Bidding Design Filing at 33-35.

⁹⁹ DC Energy at 8; J.P. Morgan at 15-16; WPTF at 6.

¹⁰⁰ Financial Marketers at 18-27; PG&E at 14-16; SCE at 8-18.

¹⁰¹ Financial Marketers at 21-23; SCE at 9-13.

physical supply and demand,¹⁰² but SCE asserts that the proposal will require physical supply and demand to subsidize virtual supply and demand.¹⁰³ The Commission should find that the ISO's proposed allocation methodology represents a balancing of stakeholder viewpoints and is just and reasonable for the reasons discussed in the Convergence Bidding Design Filing.¹⁰⁴

The Financial Marketers argue that virtual bidders should be exempted from the ISO's proposed allocation of IFM and RUC uplift costs due to the Commission's findings in an order involving ISO New England.¹⁰⁵ That order, however, concerned a methodology for allocating real-time reliability must-run operating reserve charges to virtual bidders which ISO New England proposed to revise. Based on the specific components of that allocation methodology and its financial effects in ISO New England, the Commission found that the methodology violated cost causation principles.¹⁰⁶ The ISO New England order has no bearing on whether the Commission should accept the CAISO's proposed IFM and RUC uplift cost allocation. The Commission should evaluate and accept

¹⁰² Financial Marketers at 25-27.

¹⁰³ SCE at 9-11, 13-14, 15-16.

¹⁰⁴ See *supra* note 33. Because the Commission has sufficient information to find that the ISO's proposed allocation methodology is just and reasonable, the Commission should not require the ISO to investigate alternative approaches to cost uplift allocation as separately proposed by the Financial Marketers and SCE. See Financial Marketers at 20; SCE at 19.

¹⁰⁵ Financial Marketers at 18-19 (citing *ISO New England Inc.*, 110 FERC ¶ 61,250, at P 25, *reh'g denied*, 111 FERC ¶ 61,442 (2005)). The Financial Marketers also cite "a similar exemption in the Midwest ISO [that] has since been the subject of protracted litigation that continues to this day." Financial Marketers at 19-20 (citing *Midwest Independent Transmission System Operator, Inc.*, 117 FERC ¶ 61,113 (2006), *order on reh'g*, 118 FERC ¶ 61,212 (2007), and subsequent filings in that proceeding).

¹⁰⁶ *ISO New England*, 110 FERC at P 25-33.

the ISO's proposed allocation methodology based on the specific application of that methodology to market participants under the CAISO's market design.¹⁰⁷

2. Allocation of Other Cost Uplifts

In the Convergence Bidding Design Filing, the ISO noted that, in the April 2007 Order, the Commission directed the ISO to develop a two-tier charge for real-time uplift within three years of start-up of the ISO's new market, and that the ISO will address that requirement through a separate stakeholder process.¹⁰⁸

SWP argues that, in the interests of efficiency, the ISO should address that issue in the instant proceeding.¹⁰⁹ There is no need for the ISO to address the issue in this proceeding. Since this issue is not limited to virtual bidding, the ISO has determined that the issue will benefit from separate stakeholder discussion which is most efficiently conducted on a parallel track with the instant proceeding. The ISO plans timely to submit a proposed two-tier charge for real-time uplift for implementation within the three-year time period required by the April 2007 Order, *i.e.*, by April 1, 2012.

Citing discussion contained in an ISO issue paper recently published in a separate stakeholder proceeding, SCE argues that the convergence bidding design should be modified to allocate real-time imbalance energy offset costs to

¹⁰⁷ See, e.g., *Midwest Independent Transmission System Operator, Inc.*, 123 FERC ¶ 61,297, at P 24 (2008) ("While each RTO or ISO has its own allocation for . . . costs that reflects its unique market circumstances, we must take account of the circumstances of the Midwest ISO market . . . in determining a just and reasonable cost allocation.").

¹⁰⁸ Convergence Bidding Design Filing at 35 n.66 (citing April 2007 Order at P 309).

¹⁰⁹ SWP at 11-12.

convergence bids.¹¹⁰ The Commission should not require the ISO to adopt SCE's requested modification to the convergence bidding design. The ISO is continuing to address the issue that SCE raises, which concerns price differentials between the HASP and real-time which are driving real-time offset costs, and is not pursuing a two-tier allocation scheme at this time. Also, this issue exists even in the absence of virtual bidding. For these reasons, there is no reason for the Commission to require the ISO to allocate real-time energy offset costs to virtual bids.

L. The Commission's Order on the Convergence Bidding Design Filing Will Determine How the Tariff Language to Implement It Is Drafted and How the Design Is Implemented.

Some parties suggest that the Convergence Bidding Design Filing is a purely informational filing that will lead to a merely advisory opinion from the Commission.¹¹¹ Such a characterization is inaccurate. While the ISO recognizes that it must file tariff language to implement convergence bidding, a Commission ruling on the Convergence Bidding Design Filing will provide critical guidance by resolving major policy issues. The Convergence Bidding Design Filing contains numerous concrete policies for which the ISO requests Commission approval under Section 205 of the FPA.¹¹² After the Commission issues its order, the ISO will make any necessary refinements to the draft convergence bidding tariff

¹¹⁰ SCE at 18-19 (citing ISO issue paper entitled "Analysis of Real-Time Imbalance Energy Offset (Aug. 24, 2009)).

¹¹¹ Financial Marketers at 3-4; NCPA at 3-4.

¹¹² SVP asserts that the ISO does not seek Commission approval for the Convergence Bidding Design Filing. SVP at 5. That assertion is incorrect. See Convergence Bidding Design Filing at 38.

language that is already undergoing stakeholder review, in order timely to prepare and file proposed tariff language that satisfies the Commission's directives. Thus, the Commission's order on the Convergence Bidding Design Filing will inform the tariff provisions to be submitted early next year to implement convergence bidding in a manner consistent with any Commission directive.

While the ISO recognizes that Commission approval of the tariff sheets will also be required, the Commission's order on the Convergence Bidding Design Filing will resolve the essential elements of the ISO's convergence bidding design, allowing the ISO and market participants to continue to develop software and systems based on those design elements even before the Commission acts on the tariff language that documents and implements those design elements.

M. The Commission Should Not Address Issues That Are Beyond the Scope of the Proceeding or that Are Subject to Ongoing, Separate Stakeholder Processes.

This proceeding concerns whether the ISO's proposed convergence bidding design is just and reasonable. SCE and SWP, however, request that the Commission include in the proceeding issues regarding modifications to or redesign of RUC.¹¹³ The Commission should reject these requests as being beyond the scope of this proceeding. As the ISO explained in the Convergence Bidding Design Filing, virtual bids are purely financial in nature, will not adversely

¹¹³ SCE at 23-24; SWP at 13-14.

affect the tools the ISO uses to ensure reliability, and are not part of the RUC process.¹¹⁴

Likewise, the Commission should reject SWP's request that, as part of the convergence bidding design, the ISO should provide for real-time physical demand bids.¹¹⁵ This proceeding solely concerns proposals regarding virtual bids, not physical bids.

The CPUC and SCE request that the Commission add to this proceeding the issue of the release of convergence bidding information.¹¹⁶ The Commission should deny this request, because, as discussed in the Draft Final Proposal, the ISO intends to take a broader look with stakeholders at its information release policy based on the new market design and does not believe that review should be limited to the release of convergence bidding information.¹¹⁷ To that end, the ISO has established a stakeholder process on market information release that includes discussion of convergence bidding information release.¹¹⁸ The ISO currently plans to conclude that component of the stakeholder process in the first quarter of 2010.¹¹⁹ Therefore, the information release issue will be resolved

¹¹⁴ Convergence Bidding Design Filing at 9.

¹¹⁵ SWP at 7-8.

¹¹⁶ CPUC at 4; SCE at 21-23.

¹¹⁷ Draft Final Proposal at 27.

¹¹⁸ See <http://www.caiso.com/2479/2479dde53d4d0.html>.

¹¹⁹ See ISO presentation entitled "Data Release & Accessibility Initiative Phase 2: Convergence Bidding Data Release" (Dec. 10, 2009), at slide 3. That presentation is available on the ISO's website at <http://www.caiso.com/247e/247ee8e48e60.pdf>.

through a separate process that will be concluded well before convergence bidding is implemented.

II. Conclusion

For the reasons explained in the Convergence Bidding Design Filing and in this Answer, the Commission should accept the Convergence Bidding Design Filing without modification or condition.

Respectfully submitted,

Nancy Saracino
General Counsel
Sidney M. Davies
Assistant General Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-4400
Fax: (916) 608-7296

/s/ Bradley R. Miliauskas
Sean A. Atkins
Bradley R. Miliauskas
Alston & Bird LLP
The Atlantic Building
950 F Street, NW
Washington, DC 20004
Tel: (202) 756-3300
Fax: (202) 654-4875

Attorneys for the California Independent System Operator Corporation

Dated: December 23, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing documents upon all of the parties listed on the official service list for the above-referenced proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, D.C. this 23rd day of December, 2009.

/s/ Bradley R. Miliauskas
Bradley R. Miliauskas

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