J.P. Morgan Comments

CAISO Draft Final Proposal - Price Inconsistency Caused by Intertie Constraints

Submitted by	**Company**	**Date Submitted**
Steve Greenleaf *(916) 802-5420*	*J.P. Morgan*	*June 1, 2011*

J.P. Morgan Ventures Energy Corporation and BE CA LLC (together, "J.P. Morgan") appreciates the opportunity to submit these comments on the California ISO's ("CAISO's") paper entitled, "Price Inconsistency Caused by Intertie Constraints Draft Final Proposal."

<u>Background</u>

On April 27, 2011, the CAISO issued a paper entitled "Price Inconsistency Caused by Intertie Constraints." The paper identified options for addressing certain intertie dispatch/pricing inconsistencies that have occurred in the market since the start of Convergence Bidding. At that time the CAISO identified two options for addressing the issue: 1) use different settlement LMPs for physical and virtual awards (if the physical constraint is binding); and 2) enforce both constraints, use economic curtailment to ensure that participants whose bids are selected in a range outside their offer. The CAISO stated that it favored option 1.

On May 18, 2001, the CAISO issued a Draft Final Proposal on this issue ("CAISO Proposal"). The CAISO identified an "adverse market outcome concern" with option 2, and thus eliminated it from consideration. The CAISO Proposal reiterates it support for option 1 and states that the CAISO will seek CAISO governing board approval of its proposal at the board's June board meeting.

<u>Comments</u>

As expressed in its previous comments on this matter, J.P. Morgan is concerned that option 1, under which the CAISO would use different LMPs to settle virtual and physical awards at the same location, may obviate the benefits of convergence bidding at the ties and may create unintended market consequences. Such unintended consequences include, but may not be limited to, reducing imports/exports since importers/exporters may be unable to establish an effective hedge against their physical position.

J.P. Morgan urges the CAISO to delay seeking board approval of this proposal at the June board meeting. Consistent with the comments made on the May 25, 2011, conference call on this subject, J.P. Morgan recommends that the CAISO solicit the feedback and opinion of its Market Surveillance Committee ("MSC") on this matter. The MSC and its members are uniquely qualified to examine and assess the market impacts of the CAISO proposal and may offer valuable insight as to how other organized markets have addressed similar issues. To J.P. Morgan's knowledge, no other organized electricity market that has implemented virtual bidding establishes separate pricing for physical and virtual bids at the same location. Moreover, the CAISO, the CAISO Department of Market Monitoring ("DMM"), and market participants could benefit from a discussion with the MSC regarding the concerns raised by the DMM regarding option 2 (economic curtailment) and how such concerns are or are not addressed by existing mitigation rules, e.g., the CRR clawback rule. J.P. Morgan strongly supports the ability to submit virtual bids at intertie locations and is concerned that he CAISO proposal would obviate the broader benefits of virtual bidding.

Finally, as potentially both an interim and long-term solution, J.P. Morgan requests that that the CAISO reconsider the viability of extending Bid Cost Recovery ("BCR") to exports. Such a solution would address the primary market issues/impacts caused by the intertie constraints issue. While the CAISO previously stated that it did not favor the BCR approach because it implicitly, rather than explicitly, creates two different prices, the BCR-based solution is limited in scope and would not likely have as far-ranging an impact on the market as creating two separate prices for physical and virtual bids at the same location.

J.P. Morgan appreciates the opportunity to submit these comments.