

# J.P. Morgan Comments

## CAISO Draft Final Proposal Impact of Convergence Bidding on Interties

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Submitted by	Company	Date Submitted
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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”) Draft Final Proposal entitled “Impact of Convergence Bidding on Interties.”

### Background

On April 27, 2011, the CAISO issued a paper entitled “Impact of Convergence Bidding on Real-Time Imbalance Energy Offset.” As explained by the CAISO, the real-time imbalance energy offset is a neutrality adjustment - either a charge or a payment to demand -based on whether the CAISO has sufficient revenue from real-time demand market charges to compensate supply procured in the real-time market, which includes the hour ahead scheduling process (HASP). If revenues are insufficient, the CAISO must charge demand. If revenues exceed the amount needed to pay supply, the excess is returned to demand. In that paper the CAISO stated that since HASP prices are generally and consistently lower than real-time dispatch (RTD) prices, that this price difference encourages arbitrage between intertie supply and internal demand. The CAISO proposed a new settlement rule that reverses HASP to RTD revenues for the balanced portion of a Scheduling Coordinator’s portfolio.

On May 18, 2011, the CAISO issued a “Revised Straw Proposal and Options for an Intermediate Term Solution” (“CAISO Paper”). The CAISO Paper states that the CAISO has been working on improvements to address the HASP-RTD price differential, that these efforts have resulted in a significant reduction in offset costs and therefore that, “...the ISO believes it prudent to take additional time to develop a more comprehensive intermediate term solution instead of moving ahead with the proposed short-term settlement rule.” As stated by the CAISO, “The intermediate term solution now being contemplated will address the different timing for establishing the binding prices for imports/exports and internal demand/generation in the real-time market and evaluate additional changes to the allocation methodology.” The CAISO Paper also states that a longer-term redesign of the real-time market will be addressed in the Renewable Integration Phase 2 stakeholder initiative.

On June 10, 2011, the CAISO posted a Revised Straw Proposal entitled “Impact of Convergence Bidding on Interties” (“Revised Straw Proposal”). In that paper the CAISO, the CAISO outlined three proposals: 1) retain the threshold for making an emergency filing of the proposed settlement rule; 2) remove interties as eligible convergence bidding nodes under the current market design; and 3) certain additional rules to deter implicit virtual bidding at the interties. The CAISO further states that the full redesign of the real-time market (HASP and RTD) will continue to be addressed in the CAISO’s Renewable Integration: Market and Product Review Phase 2 stakeholder initiative. The CAISO contends that the proposed changes are necessary to address certain issues and that stakeholders and the CAISO have not been able to identify alternative options that address identified issues without creating new market efficiency issues or reliability concerns.

On July 29, 2011, the CAISO posted a Draft Final Proposal entitled “Impact of Convergence Bidding on Interties” (“Draft Final Proposal”). In that paper the CAISO, the CAISO outlined its proposal 1) remove interties as eligible convergence bidding nodes under the current market design; and 2) eliminate its proposal to establish a threshold for making an emergency filing of its previously proposed HASP settlement rule.

### Comments

Consistent with our earlier comments in this process, J.P. Morgan does not support the CAISO’s proposal. Elimination of convergence bidding at the interties will result in market inefficiencies and will obviate much of the benefit of convergence bidding as proposed and implemented by the CAISO and approved by FERC. As presented by WPTF at the recent stakeholder meeting, convergence bidding at the ties offers quantifiable benefits to the market as a whole by increasing supply in the day-ahead market. The CAISO has not supported the need to take such action. The CAISO has not demonstrated that the current rules have had any deleterious impact on reliability. Furthermore, the CAISO itself has acknowledged that RTIEO charges have declined over the last month and have remained at a more moderate level. Most recently, the CAISO has presented information that reveals that the offset charge remains low and that, at times, convergence bidding has resulted in lower RTIEO charges.

As observed by the CAISO over the last two years, the level of RTIEO charges is driven by a number of factors, some within the control of the CAISO, others by market activity. As acknowledged by the CAISO, the CAISO has implemented a number of measures that have helped reduce the HASP-RTD price differences that give rise to RTIEO charges. As evidenced by information presented at the last CAISO Market Performance Planning Forum, CAISO actions in the HASP and RTD timeframes can have a substantial impact on HASP and RT price differences; actions and resulting price differences that give rise to RTIEO charges.

Rather than eliminating market instruments that can further market efficiency, the CAISO should expeditiously address those issues within its control and implement enhancements that further reflect its operational needs in market prices. However, at the end of the day, RTD prices may always be different than DA and HASP prices because the information relied upon to determine those prices, e.g., load forecasts, generator and transmission facility status, will always be more

accurate in RT. Higher RT prices and RT price spikes are not, in and of themselves, a bad thing. In fact, they are positive force when they incent resources to be available and inform better forward-market hedging and scheduling practices.

The CAISO faces significant challenges over the next few years. Renewable integration will place further strain on existing resources and will impact price signals and incentives in the market. These impacts will not be limited to California. The last thing the CAISO should do is to eliminate market instruments that assist importers in delivering firm energy to California.

J.P. Morgan once again urges the CAISO to devote its resources to the design and implementation of long-term solutions, such as the redesign of the real-time market. Such an effort is large and complex and must be completed in a timeframe that not only addresses the instant issue but supports the CAISO's and the West's larger renewable integration effort. J.P. Morgan urges the CAISO to move forward expeditiously with the Renewable Integration Phase 2 effort.

In the interim, J.P. Morgan recommends that, rather than implement measures that may in fact impair market efficiency, the CAISO continue to focus on needed refinements to its operational practices (e.g., HASP-RPTD/RTD forecasts) and further consider more targeted market solutions (e.g., solutions such as refinements to its optimization programs so that the CAISO will not artificially depress HASP prices as outlined in the previous Powerex proposal). The fact that RTIEO charges remain low provides the CAISO an opportunity to further consider and refine as necessary alternative proposals.

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