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October 2, 2009

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Re: California Independent System Operator Corporation
Docket No. ER10-____-000
Amendment to Modify Rules Limiting Supply Bid Pool in the Integrated Forward Market

Dear Secretary Bose:

The California Independent System Operator Corporation ("ISO") submits this filing to modify rules limiting the supply bid pool in the ISO's Integrated Forward Market ("IFM").[1] The ISO respectfully requests that the tariff changes contained in this filing become effective on December 2, 2009.

Two extra copies of this filing are also enclosed. Please stamp these copies with the date and time filed and return them to the messenger.

I. Need for Amendment

The ISO's market design includes a mechanism for mitigating local market power in the IFM through a series of local market power mitigation procedures known as the market power mitigation and reliability requirements determination

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[1] The ISO submits this filing pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d, and Section 35.13 of the Commission's regulations, 18 C.F.R. § 35.13. Capitalized terms not otherwise defined herein have the meanings set forth in Appendix A to the ISO's Tariff, and except where otherwise noted herein, references to section numbers are references to sections of the tariff.

(MPM-RRD) process. The MPM-RRD is performed prior to the IFM. Under these procedures, the ISO first runs the market software with only "competitive constraints" enforced. The ISO then runs the market software with "all constraints" enforced (including both competitive and non-competitive constraints). Bids from units that are dispatched to a higher level in this second run are then subject to bid mitigation in the IFM. The ISO uses forecast demand for the MPM-RRD process (which is pre-IFM) and bid-in demand for the IFM.

Under section 31.2 of the ISO's tariff, the pool of bids currently available for commitment in the IFM is limited to units that are "dispatched" in the pre-IFM process run. The original purpose of this rule was to avoid a potential dispatch of relatively high-priced unmitigated bids in the IFM, which would then set the marginal price.

The ISO has observed, however, that in some cases, limiting the pool of units considered in the IFM in this manner could create inefficiencies and raise overall costs to the market. This situation could occur when bid-in demand exceeded ISO forecast demand. The purpose of this amendment is to allow bids from resources not committed in the MPM-RRD process to compete with bids from resources that are committed in the MPM-RRD process.

II. Background and Stakeholder Process

The ISO and stakeholders decided that, on balance, it would be appropriate to include the current bid limitation rule in the initial market design. However, the ISO planned to monitor the impacts of this rule and to be prepared to eliminate the limitation if it were determined that this would improve overall market performance. In addition, the market software was designed with a feature that can remove this bid limitation without the need to change any software.

The ISO's Department of Market Monitoring ("DMM") issued a short whitepaper on June 12, 2009 indicating that it was looking into whether the rule should be retained.[2] At the June 17, 2009, meeting of the ISO Market Surveillance Committee, DMM presented results of further analysis of the potential market impacts of modifying this market rule and discussed three options for addressing the issue with the Market Surveillance Committee and stakeholders. The three options were (1) to continue to monitor the market impacts; (2) to modify the tariff or BPM to provide flexibility to respond to different market conditions; or (3) to modify the tariff to require consideration of all bids in

[2] Potential Changes in Market Design Rule Limiting the Pool of Resources Considered in Integrated Forward Market, Department of Market Monitoring, June 12, 2009, which can be found at http://www.caiso.com/23cb/23cbe3da43a30.pdf.

IFM.[3] Following these discussions, DMM initially recommended that no change be made in market rules.[4] The DMM's primary concern was that increasing the pool of bids considered in the IFM might increase the time required to reach a market solution and have a negative impact on market performance by limiting the option of re-running the IFM when issues occur trying to reach a solution for the Day-Ahead Market. DMM believed there was a potential to offset or even exceed the savings that might result from expanding the pool of resources considered in the IFM.

Several factors caused the ISO to revisit this matter. First, based on further monitoring and an analysis over the summer, the ISO confirmed that the commitment and dispatch inefficiencies and price impacts of restricting the pool of bids used in the ISO were significant. At the same time, analysis by DMM indicated that the concerns relating to local market power mitigation procedures that led to this rule did not appear to be as significant as thought during the initial market design process. Finally, software upgrades made over this period were determined to have eliminated the potential that consideration of all bids would have a negative impact on market software performance. In light of these developments, both the ISO and DMM concluded that this modification will increase overall market efficiency and help prevent extreme price spikes that could occur in the IFM in cases where bid-in demand exceeds the ISO's forecast by a significant margin. Accordingly, Management decided to reinstitute the stakeholder discussions regarding possible modification of the rule limiting the IFM supply bid pool. On August 14, 2009, the ISO held a stakeholder conference call to discuss a straw proposal, including the approach ultimately adopted in this tariff amendment filing[5].

Many stakeholders expressed support for the ISO's recommended approach. Other stakeholders expressed their preference that the ISO not change the current rule at this time, recommending that the ISO wait and implement a longer-term approach with convergence bidding. Others offered their own alternatives. Many of these stakeholders, however, indicated a preference for the ISO's recommended approach if ISO Management concluded that a rule change was necessary at this time.

A few stakeholders, however, expressed concerns that under this approach unmitigated bids might replace mitigated bids in setting the market

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[3] Potential Change in Rule Limiting Bids Considered in IFM, presentation by Keith Casey, Director, Department of Market Monitoring to the Market Surveillance Committee Meeting, June 17, 2009, available at http://www.caiso.com/23cf/23cf91423c9c0.pdf.

[4] *Initial* Recommendation on Potential Changes in Market Design Rule Limiting the Pool of Resources Considered in IFM, Department of Market Monitoring, July 2, 2009, available at http://www.caiso.com/23df/23dfb81a48990.pdf.

[5] A matrix of stakeholder comments is attached as Attachment C.

clearing price. They suggested that the ISO continue to monitor day-ahead market performance and take action if unintended outcomes are observed.

As noted above, the ISO observed suboptimal market outcomes as a result of the IFM bid pool limitation and, since concerns about market performance had been addressed with the software upgrade, ISO Management concluded that the adverse impacts of the current bid limitation on market efficiency justified a tariff amendment eliminating this limitation at this time.

III. Board Consideration

ISO Management presented its proposal to the ISO Governing Board at its September 10 meeting to eliminate the FM bid pool limitation. Management explained that allowing unmitigated resources to compete against mitigated resources would not undermine the market performance and would allow unmitigated bids to compete with mitigated bids from resources that clear the pre-IFM process when bid-in demand exceeds forecast demand. In addition, Management explained that even when bid-in demand is at or below ISO forecast demand, it is unlikely that unmitigated bids would be as competitive as bids that cleared the MPM-RRD process and, therefore, it would be unlikely that high unmitigated bids would set high prices. Expanding the pool of resources available to the IFM would, thus, improve the overall competitiveness of the IFM without undermining market performance.

The ISO Governing Board unanimously endorsed Management's proposal. A copy of Management's memorandum to the Board is included as Attachment D.

IV. Tariff Stakeholder Process and Proposed Tariff Revisions

On September 18, 2009, the ISO posted draft tariff language for stakeholder review and comment. Only one stakeholder submitted written comments suggesting clarifying editorial changes. On September 30, 2009 the ISO held a stakeholder conference call. No stakeholder raised any additional questions or comments. The ISO accepted the proposed clarifying changes and made additional non-substantive changes.

In brief summary, the proposed tariff amendment eliminates the limitation on the pool of bids that are passed onto the IFM from the pre-IFM MPM-RRD process. The amendment revises sections 31.2 and 31.2.1 to eliminate language providing that only bids cleared in the MPM-RRD process will be forwarded to the IFM. The amendment also modifies section 31.3 to provide that the IFM will consider bids that cleared the MPM-RRD in addition to bids that did not clear the MPM-RRD.

V. Effective Date

The ISO requests that the Commission make all of the tariff revisions contained in the instant filing effective as of December 2, sixty-one days from this filing.

VI. Communications

Communications regarding this filing should be addressed to the following individuals, whose names should be put on the official service list established by the Commission with respect to this submittal:

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* Individuals designated for service pursuant to Rule 203(b)(3), 18 C.F.R. § 385.203(b)(3).

VII. Service

The ISO has served copies of this transmittal letter, and all attachments, on the California Public Utilities Commission, the California Energy Commission, and all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff. In addition, the ISO is posting this transmittal letter and all attachments on the ISO Website.

VIII. Attachments

The following attachments, in addition to this transmittal letter, support the instant filing:

Attachment A	Revised Tariff sheets that incorporate the proposed changes described above

Attachment B	The proposed changes to the Tariff shown in black-line format
Attachment C	Stakeholder comment matrix.
Attachment D	Board memorandum.

IX. Conclusion

For the foregoing reasons, the Commission should accept the proposed tariff changes contained in the instant filing to become effective on December 1, 2009. Please contact the undersigned if you have any questions regarding this matter.

Respectfully submitted,

Mike Ward /SA

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Attachment A – Clean Sheets

IFM Bid Pool Tariff Amendment

Fourth Replacement CAISO Tariff

ER09-___-000

October 2, 2009

using Demand Bids as in the IFM the MPM-RRD process optimizes resources to meet one hundred percent of the CAISO Demand Forecast and Export Bids to the extent the Export Bids are selected in the MPM-RRD process, and meet one hundred percent of Ancillary Services requirements based on Supply Bids submitted to the DAM. The mitigated or unmitigated Bids identified in the MPM-RRD process for all resources that cleared in the MPM-RRD are then passed to the IFM. The CAISO performs the MPM-RRD for the DAM for the twenty-four (24) hours of the targeted Trading Day.

31.2.1 The Reliability and Market Power Mitigation Runs.

The first run of the MPM-RRD procedures is the Competitive Constraints Run (CCR), in which only limits on transmission lines pre-designated as competitive are enforced. The only RMR Units considered in the CCR are Condition 1 RMR Units that have provided market Bids for the DAM and Condition 2 RMR Units when obligated to submit a Bid pursuant to an RMR Contract. The second run is the All Constraints Run (ACR), during which all transmission Constraints are enforced. All RMR Units, Condition 1 and Condition 2, are considered in the ACR.

31.2.2 Bid Mitigation.

The CAISO shall compare the resource dispatch levels derived from CCR and ACR and will mitigate Bids as follows.

31.2.2.2 Non-RMR Units.

If the dispatch level produced through the ACR is greater than the dispatch level produced through CCR, then the resource is subject to Local Market Power Mitigation, in which case the entire portion of the unit's Energy Bid Curve that is above the CCR dispatch level will be mitigated to the lower of the Default Energy Bid as specified in Section 39, or the DAM Bid, but no lower than the unit's highest Bid price that cleared the CCR. When the ACR dispatch level is higher than the CCR level, the market Bid at and below the CCR dispatch level will be retained in the IFM. If the dispatch level produced through the ACR is not greater than the dispatch level produced through the CCR, the unit's original, unmitigated DAM Bid will be retained in its entirety.

31.3 Integrated Forward Market.

After the MPM-RRD and prior to RUC, the CAISO shall perform the IFM. The IFM (1) performs Unit Commitment and Congestion Management (2) clears mitigated or unmitigated Bids cleared in the MPM-RRD as well as Bids that were not cleared in the MPM-RRD process against bid-in Demand, taking into account transmission limits and honoring technical and inter-temporal operating Constraints, such as Minimum Run Times and (3) procures Ancillary Services to meet one hundred percent (100%) of the CAISO Forecast of CAISO Demand requirements. The IFM utilizes a set of integrated programs that: (1) determine Day-Ahead Schedules and AS Awards, and related LMPs and ASMPs; and (2) optimally commits resources that are bid in to the DAM. The IFM utilizes a SCUC algorithm that optimizes Start-Up Costs, Minimum Load Costs, and Energy Bids along with any Bids for Ancillary Services as well as Self-Schedules submitted by Scheduling Coordinators. The IFM also provides for the optimal management of Use-Limited Resources. The ELS Resources committed through the ELC Process conducted two days before the day the IFM process is conducted for the next Trading Day as described in Section 31.7 are binding.

Attachment B - Blacklines

IFM Bid Pool Tariff Amendment

Fourth Replacement CAISO Tariff

ER09-___-000

October 2, 2009

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31.2 Market Power Mitigation and Reliability Requirement Determination (MPM-RRD).

After the Market Close of the DAM, and after the CAISO has validated the Bids pursuant to Section 30.7, the CAISO will perform the MPM-RRD procedures in a series of processing runs that occur prior to the IFM Market Clearing run. The MPM process determines which Bids need to be mitigated in the IFM. The RRD process is the automated process for determining RMR Generation requirements for RMR Units. The MPM-RRD process optimizes resources using the same optimization used in the IFM, but instead of using Demand Bids as in the IFM the MPM-RRD process optimizes resources to meet one hundred percent of the CAISO Demand Forecast and Export Bids to the extent the Export Bids are selected in the MPM-RRD process, and meet one hundred percent of Ancillary Services requirements based on Supply Bids submitted to the DAM. The mitigated or unmitigated Bids~~pool of resources~~ identified in the MPM-RRD process for all resources that cleared in the MPM-RRD ~~is~~are then passed to the IFM~~ to constitute the pool of resources available for commitment in the IFM~~. The CAISO performs the MPM-RRD for the DAM for the twenty-four (24) hours of the targeted Trading Day.

31.2.1 The Reliability and Market Power Mitigation Runs.

The first run of the MPM-RRD procedures is the Competitive Constraints Run (CCR), in which only limits on transmission lines pre-designated as competitive are enforced. The only RMR Units considered in the CCR are Condition 1 RMR Units that have provided market Bids for the DAM and Condition 2 RMR Units when obligated to submit a Bid pursuant to an RMR Contract. The second run is the All Constraints Run (ACR), during which all transmission Constraints are enforced. All RMR Units, Condition 1 and Condition 2, are considered in the ACR. ~~The resources committed in the ACR form the pool of resources that is available for commitment in the IFM.~~

* * *

31.3 Integrated Forward Market.

After the MPM-RRD and prior to RUC, the CAISO shall perform the IFM. The IFM (1) performs Unit Commitment and Congestion Management~~,~~ (2) clears~~ the Energy~~ mitigated or unmitigated Bids cleared ~~as modified and~~ in the MPM-RRD as well as Bids that were not cleared in the MPM-RRD process against bid-in Demand, taking into account transmission limits and honoring technical and inter-temporal operating Constraints, such as Minimum Run Times~~,~~ and (3) procures Ancillary Services to meet one hundred percent (100%) of the CAISO Forecast of CAISO Demand requirements. The IFM utilizes a set of integrated programs that: (1) determine Day-Ahead Schedules and AS Awards, and related LMPs and ASMPs; and (2) optimally commits resources that are bid in to the DAM. The IFM utilizes a SCUC algorithm that optimizes Start-Up Costs, Minimum Load Costs, and Energy Bids along with any Bids for Ancillary Services as well as Self-Schedules submitted by Scheduling Coordinators. The IFM also provides for the optimal management of Use-Limited Resources. The ELS Resources committed through the ELC Process conducted two days before the day the IFM process is conducted for the next Trading Day as described in Section 31.7 are binding.

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Attachment C

Attachment A

Stakeholder Process: Decision on Modifying Rules Limiting Supply Bid Pool in the Integrated Forward Market

Summary of Submitted Comments

Stakeholders submitted [insert “two”, “three”, etc.] rounds of written comments to the ISO on the following dates:

- Round [One], 06/24/2009
- Round [two], 08/18/2009

Stakeholder comments are posted at: http://caiso.com/23d8/23d8bb9a6ee20.html

Other stakeholder efforts include:

- June 17, 2009, Market Surveillance Meeting
- August 14, 2009, Conference Call

Management Proposal	Calpine	CDWR/SWP	Dynegy	JPMorgan	PG&E
Modify Integrated Forward Market (IFM) to consider all supply bids rather than only those bids that cleared the Market Power Mitigation Pre-IFM Pass.	Conditional Consider making no change but if change is determined necessary then recommended Approach 1 is most transparent and least intrusive. Longer term implement Approach 4 with convergence bidding as required by FERC	Oppose Absent additional study of additional days and data where bid-in load is greater than ISO forecast, CDWR/SWP would support Approach 4	Support While not optimal , supports recommend approach 1 as providing the correct incentives in short-term but supports Approach 4 with Convergence Bidding	Conditional Prefer not change but may provide interim support for Approach 1 would be condition that there is not a significant impact to the run-time of the market. Supports Approach 4 in long-term with convergence bidding.	Support Support recommended Approach 1

Management Proposal	Powerex	SCE	SDGE	Six Cities	WPTF	Management Response
Modify Integrated Forward Market (IFM) to consider all supply bids rather than only those bids that cleared the Market Power Mitigation Pre-IFM Pass.	Support Support recommended Approach 1 as an interim approach. Supports Approach 4 with implementation of convergence bidding.	Conditional Recommended and alternative in which using reasonable point on bid-in demand curve when such point exceeds the ISO forecast. As interim approach SCE can conditionally support recommended Approach 1 in interim so long as results are monitored	Conditional While SDGE recommends Approach 3, SDGE can support an Approach 1 like approach so long as it is determined to not crate an unreasonable opportunity for unmitigated bid to set the price	Oppose Concerns about unmitigated bids under Approach 1. Support Approach 3.	Support Supports either do nothing or recommended Approach 1 as long as run-time are not impacted	On balance, the market efficiency gained by not limiting the pool of resources available to IFM outweighs the concerns of potentially unmitigated bids when bid-in demand is greater than the ISO forecast demand. Concerns about the increased run-times are manageable and are offset by recent performance enhancements.

Attachment D

California Independent
System Operator Corporation

Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel and Corporate Secretary

Date: September 2, 2009

Re: ***Decision on Modifying Rules Limiting Supply Bid Pool in Integrated Forward Market***

This memorandum requires Board action.

EXECUTIVE SUMMARY

Management proposes the ISO Board of Governors (Board) adopt a policy change to eliminate the requirement that, in the integrated forward market (IFM), the California Independent System Operator Corporation (ISO) may only consider bids on behalf of resources committed in the *market power mitigation* process. This change will increase the supply of resources available to the IFM, resulting in improved market and grid operations.

> ***Moved, that the ISO Board of Governors approves the policy to eliminate the current restriction on the supply bid pool for the integrated forward market so that all supply bids will be considered, as described in the memorandum dated September 2, 2009; and***
>
> ***Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate tariff filings with the Federal Energy Regulatory Commission to implement this policy.***

BACKGROUND

In its current day-ahead market design, the ISO mitigates supply bids before the IFM for the purpose of local market power mitigation. In this pre-IFM process, the ISO uses the same market model used by the IFM, but uses the ISO's forecast demand rather than bid-in demand. Currently, for the IFM, the ISO only considers bids from resources that are committed in the pre-IFM process. The current rule is intended to prevent the potential for high, unmitigated supply bids to set market clearing prices in the IFM.

This rule has generally worked as expected and has minimum effects on IFM results. However, it has the potential to raise overall costs in the IFM in some situations, especially when the bid-in demand is much higher than the ISO's forecast demand.

For example, on July 26, 2009, for hour-ending 17 and 18, the demand cleared in the IFM was approximately 7% higher than the ISO forecast demand. Not all available supply resources were available to the IFM due to the pre-IFM market power mitigation process. As a result, the IFM cleared at a high-priced segment of the bid-in demand curve. The average price of each of the three load aggregation points rose to between $400/MWh and $500/MWh during this two-hour period. Had all supply resources been available, lower priced, unmitigated bids would have been able to compete against higher but mitigated prices. Accordingly, expanding the pool of resources available to the IFM will improve market performance when bid-in demand exceeds forecast demand. In addition, the ISO does not believe that allowing unmitigated resources to compete against mitigated resources will undermine the market performance when bid in demand as at or below ISO forecast demand because those unmitigated bids would generally not be as competitive as mitigated bids.

Management has consulted with stakeholders and proposes to eliminate the requirement that only resources dispatched in the pre-IFM may be considered in the IFM.

CRITERIA

Management identifies two criteria for assessing whether to modify rules limiting the IFM supply bid pool:

1. *Improvement of market performance.* The proposal should improve market performance by reducing undue price volatility, especially in the situation when bid-in demand is significantly higher than the ISO forecast demand; and

2. *Preservation of market power mitigation.* The proposal should not undermine the local market power mitigation process.

STAKEHOLDER PROCESS

On June 17, 2009, the Department of Market Monitoring discussed modifying the rule governing the pool of supply bids used in the IFM with stakeholders at the Market Surveillance Committee meeting. After considering stakeholders' comments in this process, Market Monitoring recommended that the ISO not propose any immediate change to the rule, but to continue to assess the impact of the rule under different market conditions. Please see Attachment 1 for the stakeholder matrix.

At the stakeholder meeting, however, Market Monitoring did not observe or study an actual scenario similar to what occurred on July 26, 2009. Therefore, the urgency of a near term change was not immediately apparent. At the same time, Market Monitoring observed in testing that the IFM took more time to solve when considering all supply resources, rather than only resources committed in the pre-IFM process. This factor also contributed to the recommendation not to pursue a near term rule change. Due to recent software upgrades, IFM performance is no longer a concern. Management is confident that the IFM can consider all supply bids without undermining market performance.

In addition to the July 26 event, the ISO has observed market outcomes where resources appear to be economic based on their start-up cost and bid information for commitment in the IFM. However, because the resource was not economic in the pre-IFM process, the resource was not committed in IFM because IFM was not able to consider the resource under the existing rule.

In light of the July 26, 2009 event, as well as other observed market inefficiencies, Management decided to continue stakeholder talks about the possibility of modifying rules limiting the IFM supply bid pool. On August 14, 2009, the ISO held a stakeholder conference call to discuss its straw proposal. The proposal contained four alternative approaches:

- Approach 1. Use all supply bids in the IFM. In this approach, the pre-IFM will run would use the ISO forecast demand, but all bids, including those from resources not dispatched in the pre-IFM, will be made available to the IFM. In that way, the limit on the IFM supply bid pool would be entirely eliminated.

  This approach is effective when bid-in demand is significantly higher than the ISO forecast demand. It has little impact on market results in other situations, as confirmed by analyses conducted by the ISO.
- Approach 2. Use all supply bids in the IFM but only when a pre-defined trigger is activated. Only bids from resources dispatched in the pre-IFM process would be available for the IFM, unless the trigger is activated.
- Approach 3. Use the greater of the ISO forecast demand and bid-in demand in the pre-IFM process. Only bids from resources dispatched in the pre-IFM process would be available to the IFM. This approach may lead to over-mitigation and market clearing price suppression if the bid-in demand is consistently higher than the ISO forecast demand.
- Approach 4. Use the price-responsive bid-in demand curve in the pre-IFM process. Only bids from resources dispatched in the pre-IFM process will be available for the IFM. This is a Federal Energy Regulatory Commission mandate for release 2 of the ISO's new market design. This approach, without convergence bidding, may result in low MW volume cleared in the IFM.

Southern California Edison also presented an alternative approach, similar to Approach 3, at the stakeholder conference call. This alternative approach uses the greater of the ISO's forecast or quantity of bid-in demand (on a load aggregation point basis) that is bid above some threshold price level instead of the full bid-in quantity under Approach 3.

Many stakeholders expressed support for Approach 1, Management's preferred approach. They believe it is the most transparent and well-balanced among the alternative approaches discussed.

Several stakeholders expressed their preference that the ISO not change the current rule at this time recommending that the ISO wait until Approach 4 is implemented with convergence bidding. Many of these stakeholders, however, indicated a preference for Approach 1 if Management concludes that a rule change is necessary at this time.

Not all stakeholders supported Approach 1 as either their first or second options. A few stakeholders are concerned that, in Approach 1, unmitigated bids may replace mitigated bids to set the market clearing price. They suggest the ISO keep monitoring day-ahead market performance and take action if unintended outcomes are observed.

Finally, most stakeholders believe Approach 4 is the long-term solution and agree that this approach should be implemented the same time that convergence bidding is implemented.

Management has concluded that Approach 1 strikes an appropriate balance of market efficiency and market mitigation in the short-term. When convergence bidding is implemented, an approach consistent with Approach 4 will be implemented.

MANAGEMENT RECOMMENDATION

Management recommends that the Board approve Approach 1 to eliminate the limit on the IFM supply bid pool.