Stakeholder Comments Template

Subject: Update to Draft Final Proposal on Uneconomic Adjustment Policy and Parameter Values

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Pacific Gas & Electric Company (PG&E) appreciates the opportunity to participate in the Uneconomic Adjustment Policy stakeholder process and to submit comments regarding the October 16, 2008 Update to its Draft Final Proposal on Uneconomic Adjustment Policy and Parameter Values. The Update describes revised proposals for the following two items:

- The pricing parameter value to be used when there is insufficient supply of an ancillary service to meet the procurement requirement; and

- Treatment of existing rights self-schedules (TOR, ETC, CVR) under uneconomic adjustment.

PG&E does not support these revised proposals as described below.

1. Revised Proposal for Pricing Parameter Value under Ancillary Service Supply Shortfall

In the CAISO's September 19 Draft Final Proposal on MRTU Uneconomic Adjustment and Parameter Tuning, the CAISO proposed to set the pricing run ancillary service (A/S) penalty price to zero for any A/S procurement requirement that could not be fully met in the market (Zero Penalty Price Approach). After considering the comments of the stakeholders and the Market Surveillance Committee (MSC) during the September 25 public meeting the CAISO is now revising the proposal to set the pricing run A/S penalty price to the A/S bid cap, which is currently set at $250 per MW/hour (Bid Cap Penalty Price Approach).

PG&E does not support the revised proposal because it only adopts half of the MSC's recommended changes. The October 8, 2008 MSC comments state:

> "…we believe that a superior approach to this issue would be to address the market power concerns more directly through a lower offer cap for ancillary services of $150/MW, combined with a penalty parameter for procurement of A/S in the pricing run set at that same offer cap. If there is market power, it will be better mitigated by the lower offer cap and the pricing run penalty price at this

> offer cap. If there is true scarcity, firms will be able to earn prices above their offer caps without having to submit offers at the level of the offer cap."[1]

The CAISO has accepted the MSC's proposal Bid Cap Penalty Price Approach but has completely ignored the MSC suggestion of a lower A/S bid cap given the concerns about market power.[2] In fact, this component of the MSC recommendation was not discussed in the Update. By rejecting half of the MSC's balanced recommendation, the CAISO has in essence rejected the entirety of the MSC's proposal.

The concerns about market power in the A/S market are real and justify different scarcity treatment of the market for A/S from that for energy. First, the possibility for the exercise of market power is increased whenever A/S is procured locally. Second, there is currently no market power mitigation protection for the A/S market other than the A/S bid cap. The CAISO is considering a rule to provide some protection for the Markets and Performance (MAP) release (i.e., a day-ahead A/S must-offer obligation for RA resources), but that will not be in effect for MRTU's initial release. Third, PG&E believes there should be no administratively-set A/S scarcity pricing until Demand Response programs that can directly mitigate A/S scarcity are commercially ready for the market (i.e., Participating Load or Dispatchable Demand Response). Again, these programs will not be commercially ready for MRTU.

Because of these real economic concerns, PG&E believes a more limited scarcity approach for reserves is warranted. This was originally reflected in the CAISO's Zero Penalty Price Approach. If, instead, the CAISO desires to adopt the MSC's suggested Bid Cap Penalty Price Approach, then the CAISO should adopt additional design modifications that will protect against market power abuses. This might be done through a reduction of the A/S bid cap from $250/MW as suggested by the MSC. Or, alternatively, the CAISO might some enact some type of A/S market power mitigation protection for MRTU. Doing nothing leaves the market vulnerable to A/S market power abuses and is not an acceptable option in our view.

2. Revised Proposal on Treatment of Existing Rights under Uneconomic Adjustment

PG&E does not support the revised proposal for two reasons:

1. Although simple and easy to implement, this proposal is not supported by any analysis. There may be better, less costly solutions.

2. This approach does not seem practical for the RT market since it seems unlikely operators would violate transmission thermal limits instead of reducing an existing right schedule.

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[1] MSC Comments on "Uneconomic Adjustment in MRTU Market Optimizations", October 8, 2008, page 3.

[2] The MSC paper indicated a reduction of the A/S bid cap from $250/MW to $150/MW. PG&E is supportive of a reduction based on the arguments made in the MSC Comments but is not taking a position on a specific bid cap amount. We anticipate the determination of an appropriate bid cap reduction or perhaps the enactment of other A/S market power mitigation measures would be made in a stakeholder forum supported by CAISO analysis.

In this update, the CAISO proposes to set the values of the scheduling parameters associated with self-schedules submitted under existing rights existing transmission contracts (ETC), converted rights (CVR) and transmission ownership rights (TOR) to a level higher than the scheduling parameter associated with internal transmission constraints to ensure that existing rights self-schedules will not be curtailed in the IFM. This approach will relax transmission constraints before reducing the schedules for ETCs, CVRs and TORs. This will likely increase LMPs for some constrained paths.

This approach was not adequately explored in previous stakeholder meetings, and we are surprised that the CAISO is making such a significant change so late in the stakeholder process. Even more concerning, the CAISO is making this proposal without presenting any supporting analysis. Stakeholders have no basis on which to offer an educated opinion on this approach or any other approach. **PG&E requests that the CAISO provide analyses that fully evaluate the market impacts of this approach and other possible solutions.** PG&E is available to assist the CAISO in this analysis, but only the CAISO, equipped with the market software and complete market inputs, is in a position to conduct the analyses.

Based on the parameter values provided in the update, it appears that this approach will be used for both the IFM and the RT markets (i.e., the same parameter values are used in both markets). While the CAISO may perhaps make a case for this approach in the IFM where the consequences of relaxing a transmission constraint are less severe, PG&E questions how this approach can be justified in the RT market. Based on our understanding, this approach will result in the relaxation a transmission thermal constraint before adjusting an ETC, CVR or TOR schedule in RT. PG&E questions whether this is consistent with prudent utility practice. We believe the operators will not actually operate the grid in this way, and, therefore, this approach is not realistic for RT.

Finally, it appears to PG&E that the CAISO is embracing the "simplicity" of this solution primarily because it will not entail a lengthy stakeholder process or any software changes that could impact the February 1st, 2009 go-live target. We are concerned that we are compromising prudent market design for significant market elements to meet the timeline.