Western Power Trading Forum Comments on CRR Clawback 5/16/16 Modification Proposal

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WPTF appreciates the CAISO's willing to consider relaxation of the CRR Clawback rule at the interties and believes that a relaxation will support some Scheduling Coordinators' abilities to submit 15-minute bids into the Fifteen Minute Market (FMM). WPTF also supports the CAISO removing the HASP reversal rule from the bidding rule criteria. We further offer the following comments.

WPTF reiterates comments made on the 4/13 straw proposal, in particular the points below.

The CAISO's should clarify that the focus of the Day-Ahead price in the proposed change is not indicative that the Day-Ahead price necessarily reflects a demarcation between "good behavior" and "bad behavior".

Although from the CAISO's perspective it may be entirely rational to use the Day-Ahead clearing price as the demarcation between a rational bid and an irrational bid, WPTF believes it is important to acknowledge both (1) that other market forces may cause a Scheduling Coordinator to rationally bid something other than the Day-Ahead clearing price, resulting in a rational HASP bid outside of the Day-Ahead price; and (2) that the CAISO's Clawback rule is just a rule and a triggering of it does not *on its own* demonstrate the presence of any manipulative behavior.

The CAISO's proposal does not substantiate the need for the Clawback rule being implemented at the hubs and DLAPs.

During the design of MRTU the CAISO (DMM in particular) offered a summary of alternative market designs which led to the observation that markets that allowed nodal bidding had automated CRR rules and that the market (NYISO) that only had zonal convergence bidding did not. DMM further argued that since DLAPs would be distributed across many nodes using LDFs that a participant could not target a specific node for which it owns CRRs. DMM presented its CRR Clawback design to FERC and FERC found the CRR Clawback design to be reasonable.

WPTF urges the CAISO to demonstrate that application to any aggregated pricing areas is warranted. Hubs and DLAPs are important commercial transaction areas. There are lots of buyers and sellers at those locations. Virtual transactions are important hedge instruments for parties at these areas, and most parties also hold CRRs to these locations. Applying the CRR Clawback could significantly impede normal market transactions and the natural benefits of convergence bidding.

We provide an example in an appendix to these comments on how a participant could be significantly adversely impacted by such a rule. If actual instances of concern are limited, WPTF encourages the CAISO to apply other means of monitoring and enforcement rather than simply invoke the CRR Clawback rule at all locations.

WPTF appreciates the CAISO's consideration of these comments and the example on the following page.

Attachment: Trading Hub Clawback Unintended Consequence Example

Attachment – Example of Unintended Consequences of apply the Clawback Rule to the Major Trading Points

Consider the following example:

A market participant, Fred,[1] has a broad CRR portfolio with hundreds of paths both within and across each of trading hub footprints. One of the CRRs in this portfolio is for 50 MW between ZP26 and NP15.

Based on weather conditions, published outages, and previous market price signals, Fred anticipates the possibility for congestion potential tomorrow on PATH 26, North-to-South, which is a broad constraint that affects much of the CAISO market area. In anticipation of expected RT prices, Fred submits the following virtual trades for HE17 tomorrow:

- SELL 300 MW of ZP26 at $25/MWh, because Fred believes that market-wide LMPs could be worth less than $25/MWh even in the absence of any congestion (they are therefore managing risk associated with the energy component of the LMP)

- BUY 300 MW of SP15 at a price of $40/MWh, because Fred believes that congestion on the anticipated constraint could drive RT LMPs of SP to well over $40/MWh

Fred does not want to take risk on the direction of the <u>energy</u> component for tomorrow's conditions given recent -$150/MWh overgen situations, and therefore prefers to stay neutral on the energy component by having offsetting buy and sell positions in the market.[2]

DA prices clear higher than expected, with the following DA LMPs published by the ISO:

- ZP26: $30/MWh (Fred is awarded 300MW of virtual supply at this price)
- SP15: $30/MWh (Fred is awarded 300MW of virtual demand at this price)
- NP15: $45/MWh (Fred did not submit any virtual bids on this point)

Upon further examination it appears that the LMP was broken down by the ISO into the following components:

- Energy: $35/MWh
- Congestion: -$5/MWh at each of ZP26 and SP15; +$10/MWh at NP15
- Losses: $0/MWh (for simplicity of illustration)

Since the nodes bid by Fred (ZP26 and SP15) cleared the same price with no difference in congestion component between them, Fred did not contribute to congestion between the two nodes on he submitted virtual bids.

However, in the CRR Settlement Rule Adjustment process, it is noted that Fred sold 300 MW (and for sake of example, let's assume that was more than the 10% flow threshold) at ZP26, and that node was determined to have negative DA congestion in the ISO's model run.

Please consider the following outcome:

It is further noted that Fred has a CRR with a source of ZP26 (the ZP26-to-NP15 CRR path noted at the beginning of the example) which happened to profit from the DA congestion published by the ISO.

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[1] The market participant "Fred" is fictitious and is not intended to represent any actual market participant. Any reference to actual participants by the name of "Fred" is inadvertent and unintended.

[2] In the CAISO market there does not currently exist a point to point virtual transaction for congestion alone.

Fred's analysis did not assign a high probability to the DA congestion that was modeled by the ISO, and he therefore did not submit bids on that path.

Fred's analysis was correct, and in RT no congestion materializes on that constraint and the energy component is worth much less in RT than in DA. But since the ISO priced congestion in DA that affected his CRR path, even though Fred's virtual bids were not applicable to that path, Fred is subject to the CRR Settlement Rule Adjustment and is charged according to that rule. Fred would receive CRR Settlement Adjustments on all CRRs deemed to be affected by that day-ahead constraint.

Furthermore, the charge assessed to Fred could be several times what was made on the "offending" CRR paths. This can occur because the ISO assesses the flow impact that a virtual bid had on a constraint's congestion. The CRR settlement rule will not pull back more than the difference in the CRR's value settled in the IFM (with virtual bids included) minus the CRR's value if it were settled in the real-time market or HASP (in the absence of the virtual bids). Since the CRR payment was just based on the DA results (with the virtual bid included), the CRR settlement rule can pull back more that the CRR payment amount.

Further, Fred is not able to independently validate the magnitude of those charges. Although CMRI reports which virtual bid pnode impacted which constraint, hour, price and flow impact (MW); there isn't a way for Fred to validate the flow impact. In order for Fred to eliminate the risk and uncertainty associated with these charges it would have to stop participating in either the CRR or DA market.

Conclusion:

This type of scenario could and very likely would occur to any market participant that contributes to both the CRR and convergence bidding markets. Expanding the CRR Settlement Rule to trading hubs and DLAPs is likely to have broad unintended consequences resulting in punitive charges for legitimate virtual bidding activity, which will ultimately drive market participants out of the market and reduce the competitiveness, liquidity, and efficiency of both CRR and Day-Ahead markets.