

J.P. Morgan Comments on CAISO Preliminary Results of Detailed Ranking of High Priority Market Enhancements August, 2009

Submitted by	Company	Date Submitted
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J.P. Morgan appreciates the opportunity to provide these comments on the CAISO's "Preliminary Results of Detailed Ranking of High Priority Market Enhancements August, 2009." J.P. Morgan supports the CAISO's efforts to engage stakeholders in this planning exercise and a discussion of market enhancement priorities.

Process

J.P. Morgan previously submitted comments to the CAISO after the June 2009, Release Planning meeting. In those comments, J.P. Morgan raised certain concerns with respect to the CAISO Roadmap and Release Planning processes. J.P. Morgan repeats those comments here in the hope that the CAISO will make meaningful changes to these processes.

J.P. Morgan agrees that the Roadmap process should drive the release plans. Unfortunately, it appears that in some circumstances the process has been backward, where implementation challenges have resulted in certain priority items being deferred. J.P. Morgan realizes that better upfront planning and the development of realistic schedules is a necessary prerequisite to maintaining established priorities.

The Roadmap process should establish priority based solely on need, e.g., market efficiency, reliability, etc. Once the priority is established, the CAISO should undertake an exhaustive release planning analysis that incorporate feedback from vendors and market participants and a deliberate commitment of CAISO capital (both human and financial). Moreover, and consistent with the comments above, release plans should be developed with an eye to coordinating needed system/application changes across market enhancement efforts so that comprehensive schedules are developed, schedule efficiencies identified, and the CAISO and market participants work towards a common system architecture vision.

This process, however should not occur behind closed doors. While J.P. Morgan is not suggesting that market participants have a seat at the table in internal CAISO meetings, regular and timely communication with market participants is critical. J.P. Morgan suggests that the CAISO conduct monthly market forums

where both release planning and current market issues are aired. The existing Systems Interface Users Group or Settlements and Market Clearing (SaMC) groups were designed for a different purpose and are not appropriate forums for communicating these broader design and implementation issues. J.P. Morgan envisions these monthly market forums as opportunities for the CAISO to provide implementation updates and communicate schedule challenges. These forums can also be used to air current market performance issues – issues that may require the immediate dedication of resources to resolve and thus may impact the deployment schedules for other design enhancements.

Based on the CAISO's August 28, 2009, conference call on the Roadmap, J.P. Morgan remains concerned that the CAISO processes (Roadmap and Release Planning) are not aligned and recommends that information regarding market enhancement priorities and release planning be provided to stakeholders on a more frequent basis.

Detailed Ranking

The CAISO has identified the following ten enhancements as “high priority”:

- Enhancements to the Standard RA Capacity Product;
- Rules to Encourage Dispatchability of Wind and Solar Resources;
- Load Aggregation Point Granularity;
- Rules and Procedures for Applying the Resource Adequacy Must Offer Obligation for a Subset of Hours;
- Enhanced DEC Market (new);
- Multi-Day Unit Commitment in the IFM;
- Potential Modifications to Market Rules for Day Ahead Intertie Schedules;
- Bid Cost Recovery for Units Running Over Multiple Operating Days; and
- Simultaneous RUC and IFM.

The CAISO also clarified the status of four previously identified enhancements. The CAISO clarified that the following two initiatives are in process and therefore beyond the ranking process:

- Ability to Bid Start Up and Minimum Load Costs and Market Power Mitigation for Start Up and Minimum Load Cost Bids”; and
- Use of Weighted Least Squares CRR Optimization.

The CAISO also stated that it made sense to combine “Day Ahead Scheduling of Intermittent Resources” with the “Rules to Encourage Dispatchability of Wind and Solar Resources” enhancement listed above. Finally, the CAISO clarified that “Addressing Ramping Capacity Constraints” was broadened to include consideration of potential new Ancillary Service products and has been changed to a non-discretionary item.

J.P. Morgan agrees that the identified enhancements are high priority and that the CAISO should proceed with finalizing the design and implementation details related to these initiatives. J.P. Morgan further recommends that the CAISO begin to assess the potential impact of such efforts on the CAISO's existing Release Plan and how the implementation of these newly identified high-priority enhancements impacts, if at all, the implementation of initiatives already in the pipeline and the future deployment of CAISO and vendor resources.

New Products Necessary to Address Operating Requirements and Exceptional Dispatch

J.P. Morgan agrees with the CAISO's proposal to broaden the proposed enhancement entitled "Addressing Ramping Capacity Constraints" to include consideration of potential new Ancillary Service products. J.P. Morgan also agrees with the CAISO's characterization of this effort as "non-discretionary." J.P. Morgan previously made suggestions in the Roadmap process that the previously catalogued "30 Minute Ancillary Service Product" discussion be broadened to address certain of the market issues that have arisen since the start of the new market. The CAISO's recommendation to broaden the ramping capacity constraint discussion is consistent with that recommendation.

J.P. Morgan notes that FERC's September 2, 2009, order on the CAISO's Exceptional Dispatch authority and related process directs the CAISO to continue to work with stakeholders on the new products necessary to address certain of the causes of Exceptional Dispatch. The FERC order states that:¹

In light of the clarifications this order makes to the CAISO's Exceptional Dispatch Reports, which should afford greater transparency into the use of Exceptional Dispatch, and based upon the fact that several months of data are now available, the Commission's expectation is that the CAISO's stakeholder processes should move forward in assessing the reasons underlying exceptional dispatches and addressing what market products and/or solutions may be developed to limit the CAISO's reliance on Exceptional Dispatch to situations that are rare and infrequent or genuine emergencies. The CAISO should work promptly with stakeholders to develop appropriate product(s) and/or enhancements for timely implementation of identified solutions. We acknowledge receipt of the June 22, 2009 Status Report and *direct the CAISO to continue to report on the progress of the stakeholder processes at least every 120 days. Accordingly, the next report should cover approximately the first six months of MRTU. By that point in time, the CAISO and stakeholders should have a wealth of data to support meaningful stakeholder processes. We expect, therefore, that stakeholder processes will be well underway by the time of the next update and working to identify and develop any appropriate market products and/or modeling or software solutions that could limit the need for Exceptional Dispatch going-forward.* [Footnotes omitted] [Emphasis added]

Based on FERC's directive, it appears that the CAISO must expeditiously engage stakeholders on the matters addressed in the FERC order. The development of new market products or

¹ See FERC Order Accepting Tariff Revisions, Subject To Modification, Issued September 2, 2009, in Docket Nos. ER08-1178-003 EL08-88-004, at ¶51.

mechanisms may obviate the need for CAISO out-of-market instructions and may address a number of the operational and market issues experienced since start of the new market. J.P. Morgan looks forward to participating in the CAISO's efforts.

Ex Post Price Correction "Make Whole" Payments

Item 2.9 in the CAISO's Market Design Initiatives Catalogue is *Ex Post* Price Correction "Make Whole" Payments. This initiative replaces the previous enhancement entitled, "Extension of Bid Cost Recovery to Transactions Other Than Internal Supply." The CAISO states that the CAISO does not currently have a policy or mechanism to make *ex post* price corrections in instances where bids that were cleared in the market are no longer economic when evaluated against the CAISO's corrected price. This effort is intended to develop a "make whole" payment mechanism to compensate Market Participants for adverse financial impacts from price corrections.

J.P. Morgan supports this effort. The CAISO's application of its broad price correction authority has at times resulted in prices being corrected well after the current 5-day price correction window. Such corrections have at times resulted in significant adjustments to market participant revenues. J.P. Morgan therefore supports the development of a "make whole" payment mechanism to compensate Market Participants for adverse financial impacts from CAISO price corrections and agrees that this effort is "non-discretionary."

Potential Modifications to Market Rules for Day Ahead Intertie Schedules

Item 2.15 in the CAISO's Market Design Initiatives Catalogue is "Potential Modifications to Market Rules for Day Ahead Intertie Schedules." The CAISO states that, "To improve reliable grid operation and clarify market rules, the ISO is considering tariff changes to clarify the timeline for submitting e-tags for imports and exports that are scheduled or accepted in the Integrated Forward Market (IFM)." J.P. Morgan questions the CAISO's supposition that such a rule would "improve reliable operation." In fact, such a rule may in fact create a disincentive for importers to participate in the CAISO's market – hardly a benefit to reliable operation. J.P. Morgan questions why this "enhancement" is ranked high.

Admittedly, and perhaps regrettably, J.P. Morgan did not submit comments on this effort in the Roadmap process. However, J.P. Morgan did previously submit comments on this effort in the context of Convergence Bidding. J.P. Morgan's July 22 comments to the CAISO stated in part that:

The CAISO straw proposal also states that, "The ISO is also considering whether or not there should be a requirement for a NERC e-tag to be submitted for all physical DA import awards to demonstrate that the market participant had a reasonable intent to deliver energy once {Convergence Bidding} at the interties is available." At this juncture, J.P. Morgan does not support a requirement to submit a NERC e-tag with all physical DA import awards. First, to the extent that the CAISO is attempting to distinguish between physical and Convergence Bids at the Interties, the proposal to require NERC e-tags for all physical schedules is unnecessary and the object is easily achieved through other means, such as a "flag" in SiBR. Second, *requiring* the submission of a day-ahead NERC e-tag on

physical Intertie schedules is inconsistent with existing WECC practices. Currently, WECC permits entities to submit and finalize e-tags up until a short period before the operating hour. While J.P. Morgan understands the CAISO's desire to firm up and be able to rely on day-ahead import schedules, there may be legitimate business reasons why an importer is unable to secure or finalize an e-tag in the day-ahead timeframe. First, while an importer may have every intent to deliver on an import bid awarded in the CAISO's day-ahead market, that importer may need to finalize its supply arrangements outside of the CAISO's Balancing Area and thus may be unable to finalize a NERC e-tag in the day-ahead. Second, the importer may need to secure and finalize transmission service to the CAISO's Balancing Area and once again may be unable to finalize service arrangements in the day-ahead market. While J.P. Morgan makes every attempt, and usually does, submit day-ahead NERC e-tags for day-ahead market awarded import schedules, it is concerned that an explicit requirement to do so may impose unnecessary burdens on importers and may reduce otherwise available import bids into the CAISO's market. J.P. Morgan understands that the CAISO intends to hold a separate stakeholder process on this issue and intends to raise these same concerns in that forum.

J.P. Morgan does not believe that this initiative should be categorized as a high-priority effort.

Design of the Hour-Ahead Market

In its recent comments on the Roadmap process, Southern California Edison Company (SCE) stated that:

SCE remains concerned that the Roadmap process may not work for comprehensively designing and integrating multiple features aimed at addressing major market structure changes. Of note, the integration of significant amounts of intermittent resources will likely require multiple new market enhancements that must work together as a "package". The current process also fails to consider, in any detailed fashion, the true impact of integration and interaction of implementing a host of stand-alone items. Put simply, will the software be able to deal with all of these items? What will it do to software performance? How do we test the items collectively to see if they result in unintended consequences?

Consistent with its comments above, J.P. Morgan shares these concerns. As stated above, J.P. Morgan has called for the development and articulation of a common system architecture vision; a vision driven by a larger comprehensive market design framework.

J.P. Morgan's interest in this goal has in part been driven by recent design issues regarding the HASP/RT market and the need for comprehensive solutions. J.P. Morgan notes that a number of current market design efforts are related to issues that have arisen in the context of the existing HASP/RT market or may be impacted by the structure of the current HASP/RT market. Specifically, the following CAISO initiatives identify market and operational issues that exist in the current HASP/RT market or that may be in part impacted by the current structure: 1) Ancillary Services Procurement in HASP and

Dispatch Logic; 2) Real-Time Imbalance Energy Offset; and, potentially, 3) Scarcity Pricing.

J.P. Morgan posits that it may be time to reexamine the need for a full Hour-Ahead Market (HAM). The CAISO and stakeholders have long considered the need for a full, financially binding, hour ahead market. Such a HAM was in fact part of the CAISO's original new market design proposal. As a result of the implementation challenges and operating costs surrounding development and operation of a HAM, the CAISO subsequently recommended, and FERC approved, deferral of this enhancement. However, in the September 21, 2006, FERC order on MRTU, FERC stated, "We continue to agree with the commenters that a full hour-ahead market is desirable and believe the CAISO should continue moving in that direction. *For Release 1*, however, we accept the HASP proposal."² [Emphasis added] In 2008 and 2009, the HAM (item 3.1 in the catalogue) was ranked "low" as part of the CAISO's Roadmap exercise.

While J.P. Morgan understands that implementation of a HAM is no small task and cannot be accomplished in the near-term, J.P. Morgan nonetheless suggests that reexamination of the HAM effort may lead to an appropriate and comprehensive look at the structure and function of the hour-ahead market and certain of the operational and market anomalies experienced since the start of the new market. J.P. Morgan is concerned that a piecemeal approach to addressing market issues (see issue 1-3 identified above) may fail to address more overarching issues with the current HASP structure and could delay more comprehensive and economic solutions, such as introduction of a full HAM.

Conclusion

J.P. Morgan appreciates the opportunity to provide these comments on the CAISO's Preliminary Results of Detailed Ranking of High Priority Market Enhancements.

² September 21 Order at ¶204.