

Comments of Financial Marketers Coalition Regarding Extended Day-Ahead Market Straw Proposal

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The Financial Marketers Coalition¹ (“Coalition”) appreciates the opportunity to comment on the California Independent System Operator’s (“CAISO”) August 29, 2022 Extended Day-Ahead Market (“EDAM”) Revised Straw Proposal. The Coalition is concerned that CAISO’s proposal to suspend convergence bidding is a step in the wrong direction and could have significant negative impacts on liquidity and competition in the EDAM.

CAISO’s proposal notes that a transition period for convergence bidding “may be prudent to protect against any potential for unintended financial impacts and arbitrage opportunities as the EDAM is first implemented.”² Accordingly, CAISO is proposing a one year transition period without convergence bidding for EDAM market participants, with the option to include an additional one-year transition period at the end of the first year. The Straw Proposal also provides that throughout the two year transition period, CAISO will monitor and evaluate the market’s performance with and without convergence bidding in various parts of the footprint. The Coalition is concerned that

1. CAISO’s Proposal to Limit Convergence Bidding will have Significant Negative Impacts

CAISO proposes to suspend convergence bidding in the EDAM for a mandatory one-year period, followed by an optional transition year dependent on each market participant’s preference. Virtual transactions play a significant role in price formation. Incremental offer (“INC”) and decremental bid (“DEC”) virtual transactions create convergence between the Day-ahead and Real-time markets, leading to accurate price formation, more efficient market results, and the moderation of market power in the Day-ahead market. One way that virtual products help moderate market power is through the introduction of significant competition and added liquidity. A 2013 study of CAISO found that the introduction of convergence bidding created

¹ The Financial Marketers Coalition is an industry trade group made up of independent power marketing companies that trade electricity at wholesale in all of the organized ISO and RTO markets. The coalition is an active participant in many ISO/RTO stakeholder proceedings as well as in proceedings before the Federal Energy Regulatory Commission. Many of the coalition members currently trade in the CAISO market, or are interested in doing so.

² See Straw Proposal at pg. 65.

significant economic and environmental savings for consumers.³ The Wolak Study found that those savings specifically came in three areas. First, the annual total cost of fossil fuel energy decreased by about roughly \$70 million dollars per year in the year following the introduction of Convergence Bidding, through more efficient unit commitment. Second, the study found, Convergence Bidding resulted in a reduction of greenhouse gas emissions of approximately 2.8%, or between 537,000 and 650,000 pounds of emissions annually, again through better underlying unit commitment. At the same time that year, the profits extracted from the market by entities trading Convergence Bidding was approximately \$13 million in 2011 and \$18 million in 2012.⁴ This study shows profound savings to the CAISO market– with Convergence Bidding bringing value ***over four times greater*** than the cost of such trading in fuel costs alone, not including the value of avoided carbon emissions, and the longer term value of better pricing in the forward market to all market participants. Specifically, the study noted:

Although it was possible to implicit virtual bid before the introduction of explicit virtual bidding, the evidence from our analysis is that the introduction of this product significantly improved the degree of price convergence between the day-ahead and real-time markets ***and reduced the cost of serving load*** in the California ISO control area.⁵

The same results have been found in other markets. Dr. Patton, the Midcontinent Independent System Operator’s (“MISO”) Independent Market Monitor has argued for increased virtual bidding in MISO because of the value that such trading brings to the market:

A large share of the liquidity that facilitates good day-ahead market performance is provided by virtual transactions. Virtual transactions are financial purchases or sales of energy in the day-ahead market that do not correspond to physical load or resources. As such, virtual day-ahead purchases or sales cannot perform in real-time and, therefore, settle against the real-time price. Virtual transactions are essential facilitators of price convergence because they are used to arbitrage price differences between the day-ahead and real-time markets.⁶

³ JHA, A AND WOLAK, F, *Testing for Market Efficiency with Transaction Costs: An Application to Convergence Bidding in Wholesale Electricity Markets* at 23 (May 7, 2013), available at http://web.stanford.edu/group/fwolak/cgi-bin/sites/default/files/files/CAISO_VB_draft_V8.pdf (“Wolak Study”).

⁴ California Independent System Operator, *Market Issues and Performance: 2011 Annual Report* at 87 (2011), <http://www.caiso.com/Documents/2011AnnualReport-MarketIssues-Performance.pdf>; California Independent System Operator, *Market Issues and Performance: 2012 Annual Report* at 109 (2012), <http://www.caiso.com/Documents/2012AnnualReport-MarketIssue-Performance.pdf>. We note that we refer only to the profits associated with internal Convergence Bidding, and do not include values associated with Convergence Bidding at the interties or in imports/exports.

⁵ Wolak Study at 23 (emphasis added).

⁶ 2021 State of the Market Report for the Midwest ISO at 37.

Dr. Patton additionally found in 2021 that 58% of all cleared virtual transactions in MISO were efficiency-enhancing and led to convergence between the day-ahead and real-time markets.⁷

2. CAISO Should Forgo its Proposal to Suspend Convergence Bidding in the EDAM During a Transitional Period

The Coalition strongly disagrees with CAISO's proposal to suspend convergence bidding in the EDAM for up to two years, and encourages CAISO to reconsider this proposal in order to avoid competition, liquidity, and pricing issues in the EDAM market. The Coalition further notes that CAISO has provided no evidence or explanation as to why this proposal is necessary. The Coalition is concerned that, in its haste to implement measures to protect the EDAM, CAISO will implement policies that exacerbate market inefficiencies.

If you have further questions or would like to discuss these comments, please do not hesitate to contact Ruta Kalvaitis Skučas at ruta.skucas@klgates.com or Maeve Tibbetts at maeve.tibbetts@klgates.com.

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⁷ *Id.* at 39.