

**COMMENTS ON BEHALF OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON,
PASADENA, AND RIVERSIDE, CALIFORNIA ON THE
ENERGY IMBALANCE MARKET DRAFT FINAL PROPOSAL**

In response to the ISO's request, the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, the "Six Cities") submit the following comments on the ISO's September 23, 2013 Energy Imbalance Market Draft Final Proposal ("the Final Proposal").

Revisions or Clarifications Supported by the Cities - - The Final Proposal includes several revisions and/or clarifications to previous proposals that the Six Cities appreciate and support. Specifically, the Cities support:

- 1) the proposed requirement that EIM participating resources be subject to commitment by the ISO in its role as Market Operator;
- 2) the proposal to transfer uplift costs and costs associated with Bid Cost Recovery to follow energy transfers between or among BAAs through the EIM; and
- 3) the ISO's confirmation that an EIM BAA will pay GHG costs embedded in the bid price if a resource located in California is the marginal resource to meet energy imbalance needs for that EIM BAA.

The Final Proposal, however, does not adequately address the following concerns with the EIM design and its potential impacts on ISO market participants, especially LSEs within the ISO BAA:

Effects on Uplifts Associated With Virtual Bids - - In previous sets of comments, the Six Cities and other stakeholders have raised concerns that the inherent differences in the Day-Ahead Market, in which virtual bids will be submitted, and the EIM Real-Time Market, in which virtual bids would be settled, inevitably will give rise to additional uplift costs. The Final Proposal (like the 3rd Revised Straw Proposal) attempts to address a limited aspect of the potential effects of the EIM on convergence bidding uplifts, namely the effects of EIM implementation on virtual bids that are affected by constraints within an EIM BAA (*i.e.*, external to the ISO transmission grid). It is likely, however, that implementation of the EIM will have much broader impacts on convergence bidding uplifts. As to potential effects on virtual bidding outcomes at pricing nodes within the ISO, the Final Proposal simply continues to point to the ISO's efforts to improve the accuracy of the ISO's Day-Ahead modeling process and promises to consider changes to the allocation of convergence bidding uplifts resulting from constraints within the ISO if the efforts at improved modeling are insufficient.

The ISO's response concerning the potential effects of the EIM on convergence bidding uplifts is inadequate. There is no reason to anticipate that improvements in the modeling of the Day-Ahead process will be sufficient to offset potential impacts of the inherent differences between the Day-Ahead market in the ISO BAA and the Real-Time EIM covering the expanded EIM area. Even if the new and improved Day-Ahead model reflects with reasonable accuracy the anticipated transmission conditions,

loads, and resource utilization within the ISO and in neighboring BAAs operating separately, the implementation of the EIM will change the resource utilization pattern in Real-Time. Indeed, that is the stated purpose of the EIM. And because the EIM will function as a single, integrated real-time market, changes from the Day-Ahead model are likely to affect nodes internal to the ISO separate and apart from the effects of constraints in an EIM BAA. The ISO cannot ignore the effects of implementing the EIM on the outcomes of the virtual bidding process even within the ISO BAA.

The ISO's "wait and see" response to this concern is unacceptable. Convergence bidding uplifts already have imposed several hundred million dollars in costs on LSEs within the ISO. To the extent implementation of the EIM gives rise to additional uplifts associated with virtual bidding, such uplifts must be recognized as costs of the EIM that are allocated in proportion to the benefits of EIM participation. Alternatively, such uplifts reasonably could be allocated to virtual bidders. It would be patently inconsistent with the cost causation principle, however, to allocate such uplift costs to ISO load. Another temporary alternative would be to establish a reasonably limited threshold for convergence bidding uplifts upon implementation of the EIM and to suspend convergence bidding if uplifts exceed the threshold. It is not appropriate, however, to implement a market design change that by definition will result in differences between the Day-Ahead and Real-Time markets and postpone consideration of how to address potential uplifts. The ISO must take measures to deal with the potential impacts of the EIM on convergence bidding uplifts prior to implementing the EIM, not at some unspecified future time.

Remaining Concerns with Potential Capacity Leaning and Alignment of EIM Costs with Benefits - - In previous comments in this stakeholder process, the Six Cities have urged the ISO to develop an approach for allocating Energy Imbalance Market ("EIM") costs that aligns those costs with the benefits resulting from implementation of the EIM. The "costs should align with benefits" concept is one formulation of the cost causation principle. The Six Cities have urged the ISO to develop a robust methodology for determining EIM benefits as well as a methodology for identifying all costs arising from implementation of the EIM, including incremental uplift costs occurring in any participating BAA. The EIM costs should be allocated in proportion to the EIM benefits.

The alignment of EIM costs with benefits should seek to achieve two objectives. First, the market participants in one BAA should not be forced to bear extra or incremental costs in order to produce benefits for the market participants in a different BAA. That is, the EIM should "do no harm" to the participants in any BAA. The Six Cities view compliance with the "do no harm" principle as a fundamental requirement for an acceptable EIM design.

While the "do no harm" rule is a necessary element of the EIM design, it is not by itself sufficient to satisfy the cost causation principle. Assuming that EIM implementation produces overall benefits that exceed overall costs, the cost causation principle and fundamental fairness also require that participants in the different BAAs bear shares of overall EIM costs that are proportional to the shares of overall EIM benefits they receive. If, hypothetically, implementation of the EIM resulted in overall benefits of \$200 million, with \$150 million (75%) accruing to participants in BAA 1 and \$50 million (25%) accruing to participants in BAA 2, the cost causation principle requires allocation of approximately 75% of the EIM costs to BAA 1 and approximately 25% of the BAA costs to BAA 2.

The Six Cities appreciate that as the EIM design has evolved, the ISO has included measures that will tend to serve the “do no harm” objective. The Cities support such measures, including the proposals: (1) to allocate congestion costs to the BAA in which the transmission constraint giving rise to the congestion is located, (2) to require that EIM participating resources be subject to commitment by the ISO, (3) to transfer uplift costs and costs associated with Bid Cost Recovery to follow energy transfers between or among BAAs through the EIM, and (4) to apply a flexible capacity requirement to each participating BAA. While the Cities appreciate and support these features of the Final Proposal, they remain concerned that opportunities still exist for BAAs to lean on resources in other BAAs.

This is a particular concern for LSEs within the ISO, such as the Cities, because they will have no ability to limit their forced participation in EIM processes. LSEs within the ISO are subject to stringent Resource Adequacy requirements with associated must-offer obligations and resource availability standards. Because the EIM is an extension of the ISO’s Real-Time Market, both the loads and resources of the LSEs within the ISO have no option(s) to limit, hedge, or control their exposure in the EIM. Conversely, participation in the EIM is voluntary for resources outside the ISO. For this reason, there is a greater possibility that an EIM Entity outside of the ISO BAA may not bring to the EIM table capacity resources commensurate with its imbalance energy needs. As noted at page 55 of the Final Proposal, a single power balance constraint will apply to the entire EIM footprint, and scarcity can arise due to either insufficient energy bids or inadequate ramp capability. While the Final Proposal includes a mechanism to isolate the risk of inadequate ramp capability (*i.e.*, the flexible ramping requirement), there is no proposed measure to isolate the effects of insufficient energy bids. In addition, while the Final Proposal includes proposed penalties for both under-scheduling and over-scheduling of load, it does not include any measures to ensure that resources included in an EIM Entity’s base schedule will perform as represented.

The potential for disproportionate assessment of burdens and benefits remains a significant concern for the Cities. **In essence, the ISO is expanding the area to be supported by resources within the ISO to external areas that do not require participation by resources or impose the same resource adequacy standards or availability obligations.** The Six Cities again urge the ISO to include in the EIM design a process for conducting a comprehensive assessment of all costs and all benefits resulting from implementation of the EIM and assuring that responsibility for costs is reasonably aligned with receipt of benefits as required by the cost causation principle.

Request for Clarification Regarding Potential Sources for System Neutrality Costs - - The Final Proposal includes a two-tiered approach for identification and allocation of neutrality costs. In the first tier, the ISO proposes to separate neutrality costs by BAA. The Final Proposal describes the second tier of neutrality costs, which the ISO proposes to allocate to metered demand across the EIM footprint, as accounting “for any non-neutral settlement amounts which result from across BAA settlement.” However, the descriptions of the inputs for the two tiers at pages 67-68 of the Final Proposal do not provide sufficient information to distinguish between the two types of neutrality costs. The Six Cities request that the ISO provide additional explanation regarding the inputs for the two tiers, including how the inputs for each tier differ from or interact with each other. An example showing the nature of the inputs and the costs assigned to each tier would be helpful.

Recovery of Any Stranded Costs from Withdrawing Participants - - In their previous comments on several versions of the EIM straw proposals, the Six Cities requested an explanation for how EIM costs would be recovered in the event the EIM terminates or one or more EIM Entities choose to withdraw. The ISO's most recent response at page 52 of the Comments/Response matrix for the 3rd Revised Proposal reiterates the ISO's previous assertions that start-up costs are recovered through the initial implementation agreement and that on-going costs will be covered by the EIM administrative rate and states that "[n]o exit costs are expected if an EIM Entity stops participating." Whether exit costs are expected should not be dispositive. If withdrawal of an EIM BAA does not result in any unrecovered or "stranded" costs, there will be no issue. But the EIM design should include a provision for analysis to determine whether any stranded costs will occur as a result of withdrawal of a BAA from the EIM and make clear that any stranded costs identified will be the responsibility of the withdrawing BAA.

Local Market Power Mitigation - - The Six Cities generally support the ISO's proposal to apply a modified version of the Local Market Power Mitigation ("LMPM") methodology currently in effect for the ISO to mitigate bids of resources participating in the EIM. In their previous comments on the 3rd Revised Straw Proposal, however, the Cities objected to the ISO's proposal to apply LMPM to a resource only if that resource is necessary to address a constraint within the same BAA. The ISO's response at page 49 of the Comments/Response matrix for the 3rd Revised Proposal states that transfer constraints between EIM entities will be deemed competitive, that the ISO does not believe that any supplier has had local market power in another BAA under the actual network topology, and that BAAs today are responsible for resolving congestion within their areas.

The ISO's response does not adequately address the fact that even with the network topology unchanged, implementation of the EIM likely will result in substantial changes to prior bid/dispatch patterns. The Six Cities remain concerned that under the ISO's proposal, a resource with market power relative to a constraint located in a different BAA could be dispatched at an unmitigated bid price to relieve that constraint. Permitting the exercise of market power, even if the affected BAA has not been successful in resolving congestion, is not acceptable. Bids by resources with market power relative to any constraint - - wherever located - - should be mitigated. The ISO has failed to explain why the LMPM methodology could not be applied to resources dispatched to meet needs in a neighboring BAA.

Transmission Charges - - The Final Proposal maintains the ISO's recommendation that transmission for EIM dispatch, at least for an initial implementation period, not be subject to a transmission charge. A number of stakeholders have identified concerns with this proposal, including discrimination among resources participating in the EIM versus other resources and the potential that the availability of transmission in the EIM at no additional charge may discourage Day-Ahead scheduling. As one possible way of addressing such concerns, the Final Proposal at pages 79-80 reiterates the ISO's earlier suggestion that Transmission Access Charges and Wheeling Access Charges might be applied only to loads within the ISO BAA and to wheeling schedules (not including exports or EIM energy transfers). The Six Cities oppose any narrowing of the current application of transmission access charges but do not take a position at this time regarding application of transmission charges to EIM

transfers. If implementation of the EIM goes forward without transmission charges for EIM transactions, however, the ISO must be alert for potential market distortions and prepared to act promptly to address any that appear.

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