

# **CAISO WHITE PAPER**

## **Five-year Market Initiatives Roadmap 2008-2012**

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Prepared by

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# Five -year Market Initiatives Roadmap

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# **Five -year Market Initiatives Roadmap**

## **2006-2008**

### **REVISED DRAFT – August 3, 2007**

#### **Preface to this Revision**

This document is the latest in a series of updates to the California Independent System Operator's (CAISO) Market Initiatives Roadmap. One significant change with this update is that what was originally a "Three Year Market Initiatives Roadmap" has now become a "Five Year Market Initiatives Roadmap" to reflect that the CAISO has now established a [CAISO 5-Year Business Plan 2007-2011](#).

This document is the latest in a series of updates to the California Independent System Operator's (CAISO) Three-year Market Initiatives Roadmap. Key dates in the development of the Market initiatives Roadmap have been:

- June 5, 2006: Initial publication,
- June 14, 2006: Presentation to the CAISO's Board of Governors,
- July 18-19, 2006: Stakeholder meeting for discussion of the Roadmap, process of developing evaluation criteria, and certain market issues, followed by written stakeholder comments,
- August 14, 2006: Revision of the Roadmap published,
- August 17, 2006: Stakeholder meeting for presentation on evaluation criteria for prioritizing future project planning as described in the Roadmap, and more detailed discussion of certain issues, followed by written stakeholder comments,
- November 27, 2006: Revision of the Roadmap published,
- November 29, 2006: Stakeholder meeting on details of certain projects, and status of near-term prioritization, followed by further stakeholder processes on individual projects,
- March 7, 2007: Briefing to Board of Governors on Market Initiatives Ranking Methodology, and
- August 6: Revision of the Roadmap published.
- August 10: Discussion of this revised Roadmap at Market Surveillance Committee meeting,
- August 14: Conference call to discuss this revised Roadmap, and
- August 24: Due date for submitting written comments on this revised Roadmap including stakeholder priorities on future Market Initiatives.

In revising the Roadmap the CAISO has incorporated issues and potential initiatives identified by stakeholders during and subsequent to each of the 2006 Market Initiatives Roadmap stakeholder meetings (July 18-19, August 14, and November 29), as well as impacts of the Federal Energy Regulatory Commission ("FERC") Order on the MRTU tariff issued September 21, 2006, Order on requests for clarification and rehearing issued April 20, 2007, Order on

compliance filings issued June 25, 2007, and Order on tariff provisions for Congestion Revenue Rights (CRRs) and on requests for rehearing issued July 6, 2007

For ease of reference and continuity with previous versions of the Roadmap the CAISO has tried to maintain as far as possible the category structure and issue numbering established in the original June 5, 2006, document. Following the evaluation of priorities among the initiatives that are described herein, future versions of this Roadmap document may be reorganized to focus on the established priorities.

Additional details that explain these issues can be found in documents prepared by the CAISO for the meetings of July 18-19, August 17, and November 29, 2006, as well as stakeholder written comments, which are located at:

<http://www.aiso.com/1822/1822931f287d0.html>

Public discussion of the initiatives identified in the Roadmap will continue at the August 10, 2007 meeting of the Market Surveillance Committee (MSC) as well as a conference call tentatively scheduled for August 14. The CAISO will be requesting written comments from stakeholders concerning their priorities among the initiatives described in this document to be submitted by August 24, 2007.

The number and range of potential market initiatives that the CAISO and the stakeholder community could consider undertaking is limitless, whereas time and resources are finite. The CAISO is therefore applying objective criteria for determining which potential initiatives are worth pursuing and for setting priorities among those that are found to be worthy. Central among such criteria are various aspects of costs and benefits, including overall market efficiency, grid reliability, and impacts on differently-situated market participants and stakeholders. Stakeholder input for this ranking and prioritization of future market enhancements – especially clear descriptions of the business needs and benefits associated with those initiatives a stakeholder considers highest priority – will be essential to enable the CAISO to establish a plan for market enhancements that meet the needs of market participants in a cost effective manner

## 1. Introduction

Bid-based spot markets for electricity and independent system operators to run those markets are still relatively young innovations in a century-old industry. The ISOs and RTOs that exist in North America continue to learn from experience and develop modifications to their market designs to add enhancements or improve upon some aspect of their performance. In parallel to issues of spot market design, the matter of supply adequacy has multiple dimensions that are subjects of active proceedings. In addition, the various problems known generally as “seams issues” have challenged operators of adjacent control areas for decades even before the arrival of centralized energy spot markets, with only modest progress in finding effective solutions to the more difficult problems. In view of the extreme importance of electricity to all aspects of society combined with its significant annual costs, and recognizing the need to achieve further improvements in cost-effectiveness and reliability, the CAISO intends to face these challenges proactively by formulating and then executing a multi-year, systematic plan for enhancing its markets and addressing known problems. The “Five-year Market Initiatives Roadmap” described here is the CAISO’s latest revision of such a plan.

A primary goal in establishing the Market Initiatives Roadmap was to envision and then work collaboratively towards achieving the broad goals of electric restructuring, rather than identifying

and prioritizing issues on the fly, reacting to each crisis or problem as it arises. “Collaboratively” deserves particular emphasis, with respect to both determining the contents of the Roadmap and developing specific proposals to address the identified needs. Although the CAISO has taken the lead in drafting this Roadmap, it is intended to encompass a broad range of initiatives and problem areas that have been identified as high priority by external stakeholders and policy makers as well as by the CAISO itself. It includes topic areas devoted to renewable energy resources, demand response, and seams and regional issues, in addition to enhancements to the CAISO’s comprehensive market redesign known as MRTU. Its scope and content has been and will continue to be discussed with stakeholders on a regular basis to ensure that all essential matters are covered in the Roadmap. Finally, the actual effort on any given project or initiative will involve collaborative engagement with affected parties and stakeholders, in accordance with processes for developing regulatory policies and market designs that are being defined and documented by the Department of Market and Product Development and other CAISO departments.

With this latest Revised Five-year Market Initiatives Roadmap, the CAISO offers a vehicle to convey to policy makers and stakeholders a comprehensive view of the initiatives the CAISO is currently engaged in or is planning or considering undertaking between now and the end of 2012 to improve the effectiveness of its markets in supporting reliable grid operation, bringing efficient supplies of power to electricity consumers, supporting state policy priorities, and providing benefits to all market participants.

Several observations are important to reiterate. First, this Roadmap does not represent a commitment by the CAISO to undertake everything identified here, nor does it reflect relative priorities or targeted milestones or completion dates except where these have already been established. To provide a comprehensive view, the Roadmap includes some items that may be candidates for actual projects, but require further assessment to determine whether they qualify for allocation of limited resources and what their priorities should be. Part of the Roadmap process has been the CAISO’s development of objective evaluation criteria to apply to candidate projects, to help assess their benefits, costs and relative priorities. The next step in the Roadmap process, after publication of this revision, will be the application of a set of evaluation to guide the CAISO’s subsequent project planning.

Second, no version of such a Roadmap can be a fully complete and finished product, nor should it be. To be useful the Roadmap must be a living document, to evolve by extending its horizon further into the future and by incorporating new initiatives as needs are identified and prioritized.

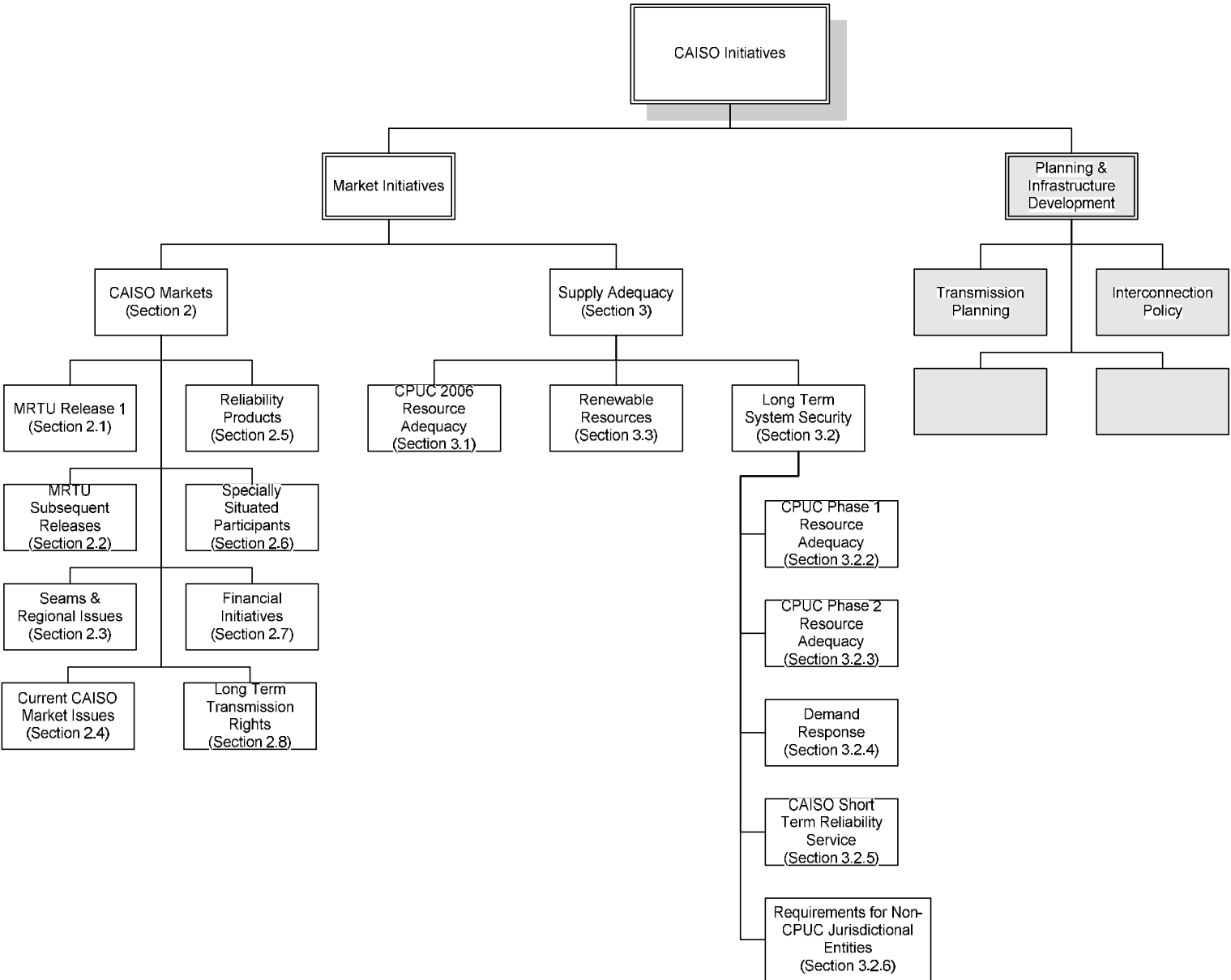
Third, the Market Initiatives described in this Roadmap are not the only initiatives the CAISO is engaged in. The more comprehensive view includes infrastructure planning and development, a core CAISO function that has its own vehicles for communicating its activities and initiatives to industry stakeholders and is therefore not included in this Roadmap. Another complement to this document is the Renewables Roadmap, which is mentioned briefly in Section 3.3 for sake of completeness but for details readers should consult that roadmap. Thus the broader view of CAISO initiatives includes this Market Initiatives Roadmap, the Renewables Roadmap, and infrastructure-related initiatives such as transmission planning and interconnection policy.

The Market Initiatives covered in this Draft Roadmap are divided into two main categories, CAISO Spot Markets (Section 2 of this document) and Supply Adequacy (Section 3). Although the elements in these categories are inter-related and affect each other, there are practical reasons for this basic distinction. Initiatives in the CAISO Spot Markets category will with limited exceptions be led by the CAISO, and will almost always be subject to FERC approval and regulation. In contrast, initiatives in the Supply Adequacy category are mostly led by state

regulatory authorities – mainly the CPUC, are subject to state or local regulation, and involve the CAISO both as a participant as well as the leader of specific processes.

The diagram on the next page is an organization chart that illustrates the categories described above and shows the major topic areas included in each category.





## 2. CAISO Spot Market Initiatives

This section describes topic areas and specific initiatives that relate directly to the operation of the CAISO spot markets. As such these initiatives will typically be led by the CAISO and will be subject to FERC approval.

### 2.1 MRTU Release 1

MRTU Release 1 is clearly a project of the highest priority for the CAISO, and is by now a well-defined and structured project. It was mentioned in the June 5 Draft Roadmap for completeness, without detailed discussion, with the following activities identified: further FERC filings related to the Tariff, including compliance filings and possible Tariff amendments; possible FERC-mandated technical workshops or other stakeholder processes; studies (LMP, Competitive Path Assessment, etc.); Business Practice Manual (BPM) development; Release 1 Training; Release 1 software integration and testing; market simulations; and post Release 1 implementation activities.

At the July 17-18, 2006, meetings and in written comments submitted afterwards, participants identified the following additional elements for Release 1 consideration. At this time, these elements have been resolved for Release 1, or their resolution is in progress. The current status is as follows.

#### 2.1.1 Study of Marginal Loss Surplus Allocation to Regional Measured Demand

In the June 2, 2006 Answer to Reply Comments on the MRTU Tariff that was filed on February 9, 2006, the CAISO agreed to study the methodology for allocating the over-collection of marginal losses to measured demand on a regional basis, using available LMP studies. The purpose of this study is to determine a credible range of marginal cost of losses to serve the demand in Northern California (NP15 plus ZP 26) and Southern California (SP15), and a commensurate range of actual cost of losses in each region. A credible range of marginal loss surplus (MLS) rebate rate (\$/MWh of Demand) for each of the two regions can then be determined and compared with system-wide marginal loss surplus rebate rate. If the system-wide MLS rebate rate falls outside the credible range of the regional MLS rebate rates beyond an acceptable margin, a process for allocation of MLS based on Regional Measured Demand may then have to be worked out; in that case the exact methodology for Regional-based MLS allocation to Measured Demand will be carried out through a stakeholder process. A White Paper on the framework for this study is located at:

<http://www.aiso.com/1831/1831d9532fd30.pdf>

An interim simplified study was performed using 5 months of available LMP data (May through September 2004) with LMP decomposition based on distributed slack. A white paper is located at

<http://www.aiso.com/184f/184f8ad86b730.pdf>

In the September 21, 2006 MRTU Order, FERC accepted CAISO's system-wide Marginal Loss Surplus allocation method as filed, but PG&E filed for rehearing requesting completion of the Marginal Loss study. In its answer, CAISO agreed to complete the study using 12 months of

LMP data (May 2004 through April 2005), and relaxing the shortcuts used in the interim study. The CAISO has completed this study, and the resulting report is available at:

<http://www.aiso.com/1bbf/1bbfd56174f50.pdf>

The conclusion of the CAISO's study is that no change in its filed allocation method or the Release 1 software is needed at the start of MRTU. The CAISO will monitor the actual allocation results using the same study methodology after the start of the MRTU market to determine if a change in its filed method and/or Release 1 software might be appropriate based on the actual market results.

Additional documents related to this issue are located at:

<http://www.aiso.com/docs/2004/11/19/2004111912470915456.html>

## **2.1.2 Application of methodology for Competitive Path Assessment**

Local Market Power Mitigation (LMPM) and Reliability Requirements Determination (RRD) functions in MRTU require prior designation of competitive and non-competitive paths in the full network model (FNM). A methodology for Competitive Path Assessment (CPA) was developed in the course of a stakeholder process in 2005 and is posted at

<http://www.aiso.com/docs/2002/08/23/200208231358035858.html>

CAISO is conducting the study to assess the merit of the proposed methodology using the current network model. The most recent results have been released on June 12, 2007, and are available at:

<http://www.aiso.com/1bf7/1bf7d3cb53320.pdf>

A second round of preliminary results will be released in late August, followed by a stakeholder meeting about two weeks later. Final path designations will be determined in late October and presented to the CAISO Board of Governors later in 2007, for their approval prior to the CAISO filing of these designations with FERC. The CAISO's Department of Market Monitoring will continue to review the results annually.

## **2.1.3 Station Power Initiative**

Station power is the energy used to operate auxiliary equipment and other load that is directly related to the production of energy by a generating unit (e.g., heating and lighting for offices located at the plant). FERC has established a policy that allows a single entity that owns one or more generating units to self-supply station power over a monthly netting period using energy generated on-site or remotely.

SCE comments on the initial Market Initiatives Roadmap proposed that generation that is self-supplying station power must do so based on the LMP at their generating facility: "That is, they must not simply be allowed to net MWh, rather the generation must net total dollars (the MWh need for station power at the LMP of the station.) Further, the CAISO may need to address this issue as part of Release 1, rather than delay implementation." (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.aiso.com/1845/18459b7a4f300.pdf> )

In April 2005, the CAISO filed Amendment No. 68 to its Tariff, to conform to FERC's station power precedent. The CAISO anticipates that its current provisions for station power will continue under MRTU. Documentation of the current provisions is provided at:

<http://www.caiso.com/1bde/1bdea4b562ad0.doc>

#### **2.1.4 Limits on Start-up/Minimum Load Costs**

SCE comments on the initial Market Initiatives Roadmap identified that the MRTU Tariff is silent regarding what generation can submit under the election of start-up and minimum load costs. SCE requested clarification that market-based minimum load costs are subject to the bid caps in place for energy, and that the CAISO cap the allowable market-based start-up costs:

“Unbounded prices present the risk of an unacceptable outcome in which a single generation dispatch causes irreparable harm to California customers. This issue must be addressed, and again this is a Release 1 issue.” (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.caiso.com/1845/18459b7a4f300.pdf> )

Following discussion with stakeholders, the CAISO provided a final proposal on June 25, 2007, for bid-caps for start-up and minimum load bids under MRTU. The CAISO management will present its proposal to the Board for consideration of this issue at the September 6-7 Board Meeting. The CAISO’s proposal is available at:

<http://www.caiso.com/1c08/1c08b3ec1a150.pdf>

#### **2.1.5 Tracking and Reallocation of CRRs as Load Migrates**

Load-serving entities (LSEs) pay congestion costs associated with moving power from its source to its sink, or point of use. Because retail customers pay for the transmission system in rates, their load-serving entity has rights to congestion-related revenues that protect them from congestion cost volatility, in the form of Congestion Revenue Rights (“CRRs”) allocated by the ISO. When customers move from one LSE to another, there is an obligation for LSEs to transfer some of their allocated CRRs so that the CRRs continue to be associated with the retail customers.

SCE suggests that the CAISO should have systems in place to track the amount of loads that migrate between LSEs: “Again, this a Release 1 issue and should be addressed as soon as possible.” (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.caiso.com/1845/18459b7a4f300.pdf>)

In response to broad stakeholder demand, the ISO’s January 29, 2007 compliance filing to implement Long Term CRRs included a proposal for the ISO to manage the transfer of CRRs to reflect such load migration. FERC’s July 6, 2007, decision on Long Term CRRs adopted that proposal. The CAISO’s proposal for the detailed rules and procedures for implementing this process has been filed with FERC on July 20, 2007. Details of the CAISO’s proposal are available at:

<http://www.caiso.com/1b8c/1b8cdf25138a0.html>

#### **2.1.6 Generation Resources for Meeting Resource Adequacy Requirements**

SCE suggested that a Release 1 issue should be the assurance that power from RA units can be dedicated to serve California load during critical periods: “SCE continues to believe this is a crucial issue and deserves immediate attention at the CAISO. Again, at least for the manual work-around, this is a Release 1 issue.” (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.caiso.com/1845/18459b7a4f300.pdf>)

FERC's September 21, 2006, decision on the CAISO's MRTU tariff (e.g., Paragraphs 116 and 117) established that exports that are supported by RA resources should have a lower scheduling priority than LSEs within the CAISO Control Area. FERC's decision also determined that exports that are supported by non-RA capacity should have a scheduling priority equal to LSEs within the CAISO Control Area. The CAISO is implementing these provisions in Release 1.

### **2.1.7 New Methodology for Pricing and Settlement of Real-time LAP Load Deviations**

The filed MRTU Tariff (as filed on February 9, 2006) provided for the settlement of real-time Load Aggregation Point (LAP) load deviations (LAP level uninstructed imbalance energy, "UIE") through a combination of an hourly LAP price (Tier 2 UIE price) and an hourly LAP price adjustment (UIE Adjustment). Over-consumption (real-time LAP load in excess of the day-ahead LAP load schedule) would be charged the sum of the LAP price and the LAP price adjustment and under-consumption (real-time LAP load below the day-ahead LAP schedule) would be paid the difference of the LAP price and the LAP price adjustment (Tariff Section 11.5.2).

Some stakeholders (SCE and NCPA) stated concerns about this approach. Moreover, in the stakeholder discussions related to the design of Convergence Bidding it appeared that having two different real-time LAP prices (depending on over- or under-consumption) would not be compatible with the idea of "price convergence" between day-ahead and real-time markets. Further scrutiny, primarily based on input from SCE and NCPA revealed that under some (albeit rare) conditions, the two-price methodology as stated in the Tariff might lead to excessive charges to a single Scheduling Coordinator (SC). Accordingly, CAISO has developed a new method for computation and settlement of real-time LAP load deviation. A white paper (<http://www.caiso.com/189b/189be9fd64170.pdf>) was discussed at the November 13, 2006 MSC meeting and is supported by the MSC. The current white paper is available at:

<http://www.caiso.com/1b87/1b87a43319f20.pdf>

The CAISO has posted draft tariff language on April 9, 2007, for stakeholder review as part of the CAISO's August 3, 2007, compliance filing.

### **2.1.8 Interim Measures to Address Day-Ahead Underscheduling**

In its September 21, 2006 Order FERC directed the CAISO to develop and file interim measures that mitigate any potential economic incentive for Load Serving Entities ("LSEs") to underschedule in the Day Ahead Market that may exist prior to implementation of convergence bidding.

This directive was repeated in the April 20 FERC Order Granting in Part and Denying in Part Requests for Clarification and Rehearing ("April 20 Order on Rehearing"). In this subsequent Order, the FERC stated that "these interim measures are not intended to prevent LSEs from taking steps to reduce the costs of serving load. Instead, these interim measures should be designed to prevent uneconomic behavior. More specifically, we expect the interim measures should address the problem of persistent underscheduling in the DAM on occasions when energy prices suggest that it would be economic to buy in the DAM."

The CAISO has been engaged in a stakeholder process on this issue since May, and an updated proposal will be presented at the September 6-7 meeting of the CAISO Board of Governors. The CAISO plans to submit a compliance filing to FERC on September 28, 2007.

*Monitoring of the current market's 95% scheduling rule, pursuant to Amendment 72, is discussed in section 2.4.2.*

Documents related to the development of this proposal are located on the CAISO website at:

<http://www.caiso.com/1bf4/1bf48b33187a0.html>

## **2.2 MRTU Subsequent Releases**

Since the introduction of the concepts of MRTU Release 1 and MRTU Release 2 during the 2005 MRTU policy resolution stakeholder process, the CAISO has been accumulating a list of candidate enhancements to the MRTU Release 1 markets to be considered for implementation in a subsequent release or releases. For two of these enhancements, FERC's September 21, 2006, "Order Conditionally Accepting The California Independent System Operator's Electric Tariff Filing To Reflect Market Redesign And Technology Upgrade" (referred to below as the "9/21/06 MRTU Order") directed their implementation by the CAISO within 12 months of the effective date of MRTU Release 1. These are described below as Release 1A, which may ultimately include other enhancements as well, based on the input that the CAISO is requesting from stakeholders as well as the CAISO's evaluation of priorities among the candidate enhancements. However, practical considerations will impose limits on what can be added to the scope of Release 1A. The CAISO's experience in completing Release 1 has been that the end-to-end time required for conceptual design, detailed design, implementation, and testing is significant, so inclusion of an enhancement in Release 1A would require the conceptual issues to already be somewhat clear. In addition, some CAISO staff time will be required during the first year of MRTU to streamline some details of Release 1's implementation, involving both the functionality of individual systems and the integration among multiple systems. For example, the implementation of scheduling priorities for exports, considering whether the underlying resource is RA capacity, (see section 2.1.6 above) requires manual processing in Release 1.<sup>1</sup> In MRTU Release 1 there is no provision for an automated communication between the Scheduling Logging for the ISO of California (SLIC), a web-enabled interface for transmission and generation owners to communicate outage information to the CAISO, and the Scheduling Infrastructure Business Rules (SIBR), the interface that accepts, validates, and modifies bids and trades for energy for processing by the CAISO's MRTU market software.<sup>2</sup> FERC directed the CAISO in its September 21 Order (paragraph 244) to implement an interface between SLIC

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<sup>1</sup> Numerous details of data inputs to the MRTU market are less apparent to market participants than the cases where market participants need to work with the CAISO to implement manual processes, but need to be resolved soon after Release 1's implementation. For example, the variation in reactive loads within the CAISO network will ultimately be determined from results from the State Estimator, but even small errors in estimates of reactive loads could cause power flow convergence problems as the market software dispatches resources to new operating points that are not in the current State Estimator solution. Therefore, the CAISO will initially use static relationships between MVAR and MW components of load, which may require periodic manual updates, but the CAISO will be working after MRTU implementation to achieve full integration between the State Estimator and market power flow solutions.

<sup>2</sup> Since SIBR will not recognize the outage information submitted through SLIC, in some cases it may modify a bid by extending the bid curve over a unit's entire operating range even though an outage has been submitted. In the Release 1 design, SLIC does interact with the day-ahead market and real-time market. Even if SIBR passes on bids that do not reflect a derate, the CAISO pre-IFM and real-time market applications will only utilize what the unit is capable of supplying. However, this process is a source of potential confusion when market participants are notified that their bids are being extended into operating ranges for which they have properly reported outages.

and SIBR as of the earlier of MRTU Release 2 or the time that SLIC derates become recognized by SIBR and SLIC interacts with the day-ahead and real-time markets. The CAISO will need to ensure smooth functioning of Release 1, such as automation of the initial manual processing and completion of data interfaces among software systems, before committing to a broad scope of market enhancements.

The CAISO also needs to recognize that events that cannot be foreseen currently could accelerate some market enhancements. For example, section 2.2.25 (“Partial RA Units”) concerns generators for which only a portion of the available capacity is designated for meeting RA requirements. This was previously seen as a candidate for implementation sometime after Release 1, but as Release 1 moved through its detailed design stages, needs were recognized to implement this feature in Release 1.<sup>3</sup>

The 9/21/06 MRTU Order (P 33) directed certain additional design enhancements to be made by the time of MRTU Release 2, which FERC described as being implemented about three years after Release 1. For other enhancements that FERC did not specify either within 12 months of MRTU implementation or in Release 2 and that remain under consideration by the CAISO, there is no definitive schedule at this time for a subsequent MRTU release, nor has the CAISO made a firm commitment to implement any specific element in a subsequent release. The CAISO has, however, committed to conduct the following activities with regard to MRTU subsequent releases, and to engage stakeholders in these activities.

- Specification of criteria for evaluating and prioritizing candidate elements for inclusion in a subsequent implementation, as described in the introduction.
- Scoping of MRTU post-Release 1 through a process of defining the candidate elements, subjecting them to the criteria developed in the previous activity, and prioritizing among those candidates that meet the criteria to determine a preferred feasible set of elements for a single release.

At this time the following initiatives are identified for possible post-Release 1 implementation.

### **2.2.1 Convergence Bidding: MRTU Release 1A**

Convergence (or virtual) bidding is a mechanism whereby market participants can make financial sales (or purchases) of energy in the Day Ahead market, with the explicit requirement to buy back (or sell back) that energy in the Real Time market, thereby potentially moving the Day Ahead and Real Time prices closer together.

FERC’s 9/12/06 MRTU Order (P 430-452) requires the CAISO to implement convergence bidding within 12 months of MRTU Release 1. FERC’s 4/20/07 Order (P 105-119) specifies that the CAISO must file tariff language for the implementation of convergence bidding no later than 60 days prior to the one year anniversary of MRTU startup.

The CAISO conducted a public forum on convergence bidding on June 13, 2006, and subsequently hosted stakeholder conference calls with staff from PJM, NYISO and ISO-NE to learn about the practices and impacts of virtual bidding in other ISOs. The CAISO is currently

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<sup>3</sup> Other sections for which at least a partial implementation is provided in Release 1 include 2.2.11 (Multi-day unit commitment in the IFM), 2.2.16 (Ancillary Service Self-Provision at the Interties) (for dynamic schedules), 2.3.2 (Interchange transactions after the Real Time Market) (for dynamic schedules), 2.3.3 (Import and Export of Ancillary Services), 2.3.6 (Dynamic/ Pseudo Tie Imports), 2.3.8 (Dynamic Scheduling for Load and Generation), 2.6 (Specially Situated Participants), 2.7 (Financial Incentives), and 2.8 (Long-Term Transmission Rights).

engaged with stakeholders to develop the conceptual design for convergence bidding. Related documents and written stakeholder comments are posted at:

<http://www.aiso.com/1807/1807996f7020.html>

Additional discussion documents are located at:

<http://www.aiso.com/1822/1822931f287d0.html>

FERC's 9/21/06 MRTU Order also found that the harm of further delaying the substantial benefits of MRTU outweigh the potential benefits that are to be gained by implementing convergence bidding in Release 1, but agreed with commenters that Release 1 must include provisions to offset LSEs' incentive to underschedule in the day-ahead market. The Order directs the CAISO to develop and file interim measures, no later than 180 days prior to the effective date of MRTU Release 1, to address the potential economic incentive for LSEs to underschedule in the day-ahead market until the successful implementation of convergence bidding has been achieved. Documents in the CAISO's process for establishing a day-ahead scheduling requirement for Release 1 are available at:

<http://www.aiso.com/1bf4/1bf48b33187a0.html>

## **FERC MANDATED – RELEASE 1A**

### **2.2.2 System-level Scarcity Pricing: MRTU Release 1A**

The current MRTU design provides for scarcity pricing for Energy; however, no explicit measures are included for scarcity pricing of Reserves. In the MRTU Release 1, Reserve prices may exceed the bid cap to the extent of the opportunity cost of Energy. In other words, Reserve prices will generally be limited to the sum of the prevailing bid cap for Reserves plus the prevailing bid cap for Energy. The question that has faced the CAISO is whether (a) this implicit scarcity pricing (double cap) is adequate for scarcity pricing of Reserves, or (b) explicit scarcity pricing for Reserves should be provided.

FERC's 9/21/06 MRTU Order (Paragraphs 1077 to 1079) found that the CAISO's proposal is too narrowly tailored, and that prices should rise to reflect the increased need for reserves and energy, whether or not the shortage arises in conjunction with a generation or transmission outage, in both the day-ahead and real-time markets. While FERC concluded that the CAISO's limited scarcity pricing proposal is a reasonable start for implementation of MRTU, the CAISO should further refine its proposal to include a more broadly-triggered reserve shortage scarcity pricing, and on a more accelerated basis, to ensure that prices are not inappropriately suppressed during periods of genuine scarcity. The Order directs the CAISO to file tariff language for the implementation of an expanded scarcity pricing methodology within 12 months of the effective date of MRTU Release 1. Furthermore, the Order directs the CAISO to develop a reserve shortage scarcity pricing mechanism that applies administratively-determined graduated prices to various levels of reserve shortage, to be implemented within 12 months after Release 1.

The CAISO has initiated its stakeholder process for development of post-Release 1 scarcity pricing mechanisms. The CAISO's Scarcity Pricing Issue Paper was published on May 31, 2007, and stakeholder comments were received in June. These documents are available at:

<http://www.aiso.com/1bef/1bef12b9b420b0.html>



**FERC MANDATED – RELEASE 1A****2.2.3 Day-Ahead Market Power Mitigation and Unit Commitment Issues Based on Bid in Demand**

In reviewing the CAISO's market design, the consultants LECG suggested the use of bid-in Demand rather than Demand forecast in Pre- Integrated Forward Market (IFM) passes in the Day-Ahead Market. LECG also recommended eliminating use of extreme DEC bids in Pass 2 pre-IFM for schedules selected in the Pass 1, and unrestricting the pool of resources in IFM and RUC based on unit commitment in Pre-IFM. LECG's comments (February 2005) on these issues is located at:

<http://www.aiso.com/docs/2005/02/23/200502231634265701.pdf>

A related issue not addressed by LECG (or FERC) that will have to be worked out if pre-IFM is to be based on bid-in demand is RMR pre-dispatch. RMR pre-dispatch relies on the use of forecast rather than bid-in demand.

FERC's 9/21/06 MRTU Order (P 1089) conditionally accepted the CAISO's proposal to use forecasted Demand in Pre-IFM passes, subject to the CAISO instituting bid-in demand as the basis for applying market power mitigation in the pre-IFM runs no later than MRTU Release 2 to reduce the likelihood of over-mitigation of suppliers.

FERC's 4/20/2007 Order (P 193) re-iterated that the CAISO must implement bid-in demand in the pre-IFM run by MRTU Release 2. In addition, the CAISO's Market Monitoring Unit was directed to monitor and report on the effects of market power mitigation in the day ahead using the CAISO's load forecasts instead of bid-in demand, including a comparison with an estimate of what the amount of mitigation would have been with bid-in demand, in the CAISO quarterly status reports filed in ER06-615.

**2.2.4 Simultaneous Residual Unit Commitment (RUC) and IFM**

In the current MRTU design Residual Unit Commitment (RUC) is performed after completion of the IFM and does not impact Day-ahead Market Energy, Ancillary Services (AS), and Congestion/CRR pricing and settlement. The issue here is whether to perform IFM and RUC simultaneously, and if so, how.

**2.2.4.1 Multi-Hour Block Constraints in RUC**

SCE raised a concern that resources may be committed for a time period that is inconsistent with its offer, because RUC does not observe any multi-hour block constraints. "SCE requests that the CAISO revise its software to honor multi-hour block constraints in RUC for Release 2." (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.aiso.com/1845/18459b7a4f300.pdf>)

FERC's 9/21/06 MRTU Order (P 1280) finds SCE's request reasonable that the CAISO should honor multi-block constraints as a bidding parameter for system resources in the RUC process, and reiterated the finding that the CAISO should examine whether such software changes could be implemented by Release 1, or to implement them as soon as feasible. In its application for rehearing, the CAISO pointed out that the purpose of RUC is to procure capacity for potential dispatch in Real-Time, when multi-hour block constraints cannot be enforced, and that the cost

of implementing SCE's proposal would be significant. FERC granted the CAISO's request for rehearing, and changed its order to direct the CAISO to implement this feature in Release 2.

## **FERC MANDATED – RELEASE 2**

### **2.2.5 Dispatchable Demand Response**

The CAISO intends to fully support Dispatchable Demand Response (“DDR”) in its MRTU software design. Price-responsive demand will be able to participate in the Day-Ahead forward Energy market under MRTU. Such demand resources will be able to submit price-sensitive bids at Load Aggregation Points and then settle any deviations from the final Day-Ahead schedule at the Real-Time Imbalance Energy price for that Load Aggregation Point. In addition, Participating Loads – i.e., Load that participates in the CAISO's Imbalance Energy and Ancillary Services markets as well as pumped storage facilities – are types of DDR resources that are modeled with added functionality in the CAISO's MRTU software. In the MRTU software Release 1, Participating Load will be able to participate in the wholesale Energy and Ancillary Services markets with certain limitations based on software functionality. The CAISO is working to address some of these limitations in the Release 1 software and intends to develop a more robust and comprehensive integrated solution for the participation of DDR resources post Release 1.

A full DDR model will not be incorporated into Release 1 of the MRTU software design. In 2005, LECG identified a design concern related to Participating Load that would have resulted in inequities between prices settled at Load Aggregation Points and those settled at individual nodes if a full DDR model was included in Release 1. Based on this finding, the CAISO recognized the need to get the design, rules and validation for DDR “right” and therefore deferred the full implementation of DDR to occur post Release 1. FERC's 9/21/06 MRTU Order (paragraphs 688 and 689) noted that the CAISO had committed to work with market participants to provide additional opportunities for demand response in Release 2, and accordingly, directed the CAISO to work with market participants to present additional opportunities for demand response resources to participate in the CAISO market. FERC's 4/20/07 and 6/25/07 Orders have reiterated FERC's guidance to provide additional opportunities for demand response.

Post Release 1, the CAISO's full Dispatchable Demand Response model should consider incorporating the following attributes and functionality:

- A three-part bid consisting of:
  - Load curtailment cost
  - Minimum load reduction cost
  - Load energy bid
- Load curtailment time (time to curtail load)
- Minimum load reduction time (min time after load curtailment)
- Minimum base load time (min time after load restoration)
- Maximum number of daily load curtailments
- Load drop rate
- Load pickup rate
- Maximum Non-spinning reserve capacity (load reduction within 10 minutes)

The DDR model should also incorporate the following additional features:

- The base load component is a price taker, *i.e.*, it is charged the relevant aggregate LMP as any non-participating load irrespective of dispatch
- When the DDR is dispatched from the base load, it is eligible for recovering its load curtailment cost and its hourly minimum load reduction cost
- When the DDR is dispatched, it is paid its LMP for the load reduction

Finally, RTOAdvisors comments that Electric Service Providers (ESPs) seek assurance that DR programs will count toward meeting Resource Adequacy requirements, and seek to include “any additional issues that arise that would affect RA counting for DR.” (See Comments of RTOAdvisors, July 28, 2006 at:

<http://www.caiso.com/1845/18459965461b0.pdf>)

Note: Recognizing that most of the existing Participating Loads are large hydro pumps, the MRTU Release 1 will support having participating pump load (or other Participating Load that can operate like a pump) participate as DDR using what the CAISO refers to as the “pump/storage” model. While the pump/storage model is able to provide some desired attributes of a DDR resource (e.g., multi-part bids and some inter-temporal constraints), it has limitations including an inability to aggregate loads that share common metering. Therefore, as an alternative to the pump/storage model, the CAISO is also prepared to support Participating Loads using the same Energy Bid structure as non-participating Loads, and to support the eligibility of Participating Loads to provide Non-Spinning Reserve through a manual work-around, provided that metering and the network topology support this arrangement.

The CAISO has recently begun to explore in detail what will be necessary to implement the full Participating Load model as a post-Release 1 market enhancement. In addition to being part of the CAISO’s own Demand Response initiatives as described in section 3.2.4, this is the focus of one of five working groups in a coordinated effort by the CAISO, California Public Utilities Commission, and California Energy Commission.

## **FERC MANDATED – RELEASE 2**

### **2.2.6 The CEC’s proposal on rebate of loss over-collection for renewable resources**

In Spring 2005 in the context of the MRTU stakeholder process the California Energy Commission (CEC) proposed a method for reducing the impact of LMP-based marginal transmission loss charges on intermittent resources. At the time the CAISO and the stakeholders agreed to defer discussion of this proposal for consideration after MRTU Release 1. Subsequently, in the 2005 MRTU stakeholder and policy resolution process the CAISO agreed to modify the crediting back of marginal loss surplus revenues and accelerate that process, so the question here is whether special treatment for intermittent resources is still needed, and if so, how. FERC’s 9/21/06 MRTU Order directs the CAISO to address issues related to the integration of intermittent resource issues, including transmission line loss over collection issues, in Release 2.

## **FERC MANDATED – RELEASE 2**

### **2.2.7 Consideration of a full Hour-Ahead settlement market**

This issue is whether to augment the two-settlement market design of MRTU Release 1 with a third Hour Ahead settlement market, which could be either a substitute for or in addition to the Hour Ahead Scheduling Process (HASP) element of the Release 1 design.

### **2.2.8 Dynamic pivotal supplier test for market power mitigation**

Local Market Power Mitigation in Release 1 is accomplished through prior classification of transmission constraints as “Competitive” or “Non-competitive”. The question here is whether this process should (or could) be replaced by “on-the-fly” determination of pivotal suppliers in the market-clearing process.

## 2.2.9 Multi-settlement system for Ancillary Services

LECG's February 2005 report stated that the lack of a full multi-settlement system for Ancillary Services that optimizes real-time reserves and settles deviations from day-ahead schedules at real-time prices could raise consumer costs when reserves scheduled in the Day Ahead market must generate energy in Real Time as a result of minimum run times, minimum down times or transmission constraints. The Release 1 design procures AS in the Day Ahead market to meet 100% of forecasted real-time needs, and then procures additional AS incrementally in Real Time only to the extent that they are needed due to changes in system conditions or demand exceeding the Day Ahead forecast. Moreover, unless the Operating Reserves are designated as "Contingency Only", their energy will be dispatched economically, and if as a result the Operating Reserves fall below the North American Electric Reliability Corporation (NERC) and Western Electricity Coordinating Council (WECC) Minimum Operating Reserves Criteria (MORC), CAISO will procure additional Operating Reserves in real-time. The question to be considered is whether to modify the Release 1 design to create a multi-settlement AS market as suggested by LECG.

In MRTU Release 1, FERC's 9/21/06 Order on MRTU found it reasonable for the CAISO to limit Ancillary Services substitution opportunities to units that are in the appropriate location and whose bids clear in the relevant market, but directs the CAISO (Paragraph 303) to address the possibility of added flexibility for substitution of the source of Ancillary Services in future MRTU releases.

In the 4/20/07 Order FERC reiterated that for Release 1, the Commission accepts the ancillary service substitution proposal, and that there was no basis for reversing the prior determination and for the CAISO to address this issue in future MRTU releases.

### **FERC MANDATED – Future MRTU Release**

## 2.2.10 Consideration of import energy in the RUC process

Early in the 2005 MRTU stakeholder process it was suggested that import energy bids that were not cleared in the IFM could be considered in the RUC optimization by treating such bids in the same manner as the minimum load bids of internal generators that were not committed in the IFM. The question to consider is whether, in light of the treatment of imports in RUC as filed in the Release 1 MRTU tariff, any additional provisions for considering imports in RUC are needed or appropriate.

## 2.2.11 Multi-day unit commitment in the IFM

In MRTU Release 1, the forward looking time horizon in IFM is one day, taking into account the impact of prior commitment of units with very long start up times. During the MRTU Stakeholder meetings there were requests that the CAISO make commitment decisions in the IFM that look out beyond a single day in order to create a commitment decision that is more efficient and better reflects the impact of startup-up cost for resources that have long start-up times. There are several design issues, including the need for bidding and bid replication rules as well as software performance and solution time requirements that must be discussed and resolved via a stakeholder process before considering modification of the software to accommodate Multi-Day unit commitment in IFM.

As the CAISO completed its design for Release 1, the CAISO found that there is an opportunity to run an optimization process, "Extremely Long-Start Commitment" (ELC), following the Residual Unit Commitment (RUC) process. The RUC process is able to consider unit

commitment to meet the CAISO's forecasted demand for generators with up to 18-hour start-up times, but there is a small number of generators with start-up times exceeding 18 hours. The ELC process gives the CAISO to determine when it should commit these generators, for reliability purposes, by using a 48-hour optimization period. Further details of the ELC process are available in section 6.8 of the BPM for Market Operations, at:

<http://www.caiso.com/17e9/17e9d7742f400.html>

There may be limitations on the economic optimality that can be achieved by using separate ELC, RUC, and IFM processes, but these may be unavoidable due to assumptions that bids submitted to the Day-Ahead Market will be applicable on the following day.

### **2.2.11.1 Bid Cost Recovery for Units with Run Times that exceed 24 hours**

The issue was raised by SoCal Edison that section 11.8.2.1.1 of the MRTU Tariff is problematic because it does not fully consider units which have run-times that exceed 24 hours. SoCal Edison requested that the MRTU Tariff be modified to divide the start-up costs by the total run-time of the unit even if the run-time exceeds 24 hours. Absent this modification uplift charges to market participants could be artificially inflated.

In FERCs September 21 Order (paragraph 533) the CAISO was directed to “develop and file with the Commission a plan for units facing these types of constraints for implementation no later than MRTU Release 2”.

#### **FERC MANDATED – RELEASE 2**

### **2.2.12 Relax DEC Bidding Activity Rule on Final Day-Ahead Resource Schedules**

The bidding activity rules in MRTU Release 1 disallow post Day-Ahead Market reduction below the Day-Ahead energy schedule at energy prices that are lower than what was bid in and accepted in the Day-Ahead Market. This activity rule was designed to prevent the “DEC” game in situations where transmission derates require re-dispatch of generation in the real-time market. LECG pointed out problems with this activity rule. The issue under consideration is to relax this activity rule without the risk of creating “DEC” game incentives. One proposed solution is to allow a limited re-bid period shortly after the publication of the Day-Ahead market results (e.g., between 1:00 p.m. and 3:00 p.m.) without enforcing this activity rule. Accordingly, during the re-bid period, accepted Day-Ahead bids can be changed above or below the corresponding Day-Ahead bid prices for use in the Real-Time market.

#### **FERC MANDATED – RELEASE 2**

### **2.2.13 Ramping Limits for the Real-Time Pricing Run with Constrained Output Generation (COG)**

The February 2005 LECG report stated that the mechanism proposed for implementation of real-time constrained output generator (COG) pricing could result in the calculation of inappropriately high prices during circumstances in which uneconomic gas turbines are operating as a result of either minimum run time or minimum-down time constraints. The proposed solution to be considered, which is used in the NYISO markets, is to use the dispatch level of non-COG resources from the previous interval's pricing run as the initial operating point of the non-COG resources in the pricing run for the current interval, rather than using telemetry as basis for the initial operating point of non-COG resources as the Release 1 software will do.

When further analysis is considered concerning this issue, it would be desirable to consider this issue together with the ramp rate issues that are identified in Section 2.2.15, because both issues involve the mathematical algorithms of computing ramping constraints.

### **2.2.14 LMPM for COG units; provision for daily bidding of minimum load**

In the course of the stakeholder discussions and during the Tariff page turn in 2005, several participants commented that the ability for the COG resources to bid their Minimum load on a daily basis, subject to local market power mitigation, was stated as a highly desirable feature. This issue would explore how to implement this possible post-release 1 feature.

### **2.2.15 Ramp Rate Enhancements**

Operational ramp rates are used for scheduling and dispatch in real time. In order to maintain performance of the software within the required solution timing parameters, the number of operational ramp-rate segments supported in Release 1 is limited to 4 (versus 10 segments initially contemplated). Only 5% of the resources with ramp-rates operational ramp-rates defined in the Master-File would have ramp rates with more than 4 segments defined. Some participants have concerns about the reduction in the number of ramp-rate segments. After actual performance is determined, the CAISO can work with its vendor to determine if additional operational ramp-rate segments can be supported.

While a separate Operating Reserve ramp-rate is used for procuring the spinning and non-spinning reserves, the Operational ramp rate is used for all dispatching of a resource. To the extent the operational ramp rate at a given operating level is less than the Operating Reserve ramp-rate, the resource may be subject to AS “No-Pay” charge for reserves that are not actually available based on the lower Operational ramp rate. Modifications to the software would be necessary to more closely align procurement of AS with energy dispatch from AS capacity in real-time.

### **2.2.16 Ancillary Service Self-Provision at the Interties**

The MRTU Release 1 design did not include the self-provision of Ancillary Services from interties. Import AS could only be bid and must compete with import energy bids for the use of New Firm Use (NFU) transmission capacity. This issue would explore whether AS self provision from the inter-ties can be expanded as a potential post-Release 1 feature.

As the CAISO’s detailed design of MRTU has progressed, the CAISO is considering the prospect that self-provision of AS can be accommodated for dynamic imports. This prospect may be sufficient for the currently anticipated market needs. This topic may have overlapping issues with the direction in FERC’s 9/21/06 Order on MRTU (Paragraph 326) to ensure that all provisions of ancillary services, self-provided or not, are subject to the same regional constraints. To the extent that this topic is considered further, this topic would be combined with section 2.2.17 (Reservation of transmission capacity for Ancillary Service exports) since the underlying issue of reserving capacity is common to both issues.

In the April 20 FERC Order Western raised concern that its Boulder Canyon Project (Project) customers in the CAISO Control Area currently self-provide ancillary services from the Project over the intertie and into the CAISO Control Area and that the September 2006 Order is unclear as to whether these customers can continue to self-provide ancillary services from Western’s Control Area to the CAISO Control Area. FERC directed the CAISO to work with Western

determine whether the CAISO's work-around is acceptable to Western and to propose any tariff revisions no later than 180 days prior to the implementation of MRTU Release 1

### **2.2.17 Supporting Exports of Ancillary Services**

Under MRTU Release 1 there is no formal mechanism or specific process for bidding for exports of AS, or for scheduling on-demand export of AS. The optimization does not reserve transmission capacity for this functionality. In MRTU Release 1, a manual workaround will be provided for entities with on-demand obligation; to the extent transmission capacity is available (or must be reserved according to ETC/TOR rights). This issue would explore how to build the reservation of transmission capacity into the optimization so that market participants who might have an obligation to supply Ancillary Service energy in real-time to neighboring control areas can serve this obligation. FERC's 9/21/06 Order on MRTU (Paragraph 355) directs the CAISO to develop software to support exports of ancillary services in the future through stakeholder processes and to propose necessary tariff changes to implement this feature no later than Release 2.

**FERC MANDATED – RELEASE 2**

### **2.2.18 Hourly rather than daily designation of Ancillary Service Contingency Only Flag**

In MRTU Release 1 the designation of "Contingency Only" Ancillary Services is accommodated on a daily basis. This issue would explore provisions for hourly designation of "Contingency Only" AS a potential post-Release 1 feature.

### **2.2.19 Multi-Segment rather than single segment Ancillary Service Bidding**

In MRTU Release 1, Ancillary Services Bids consist of a single Bid segment. In comments leading up to FERC's 9/21/06 Order on MRTU, Powerex requested that multi-segment bidding should be provided for some Ancillary Services. While FERC did not impose this requirement in MRTU Release 1, FERC directed the CAISO (Paragraph 341) to file a report, before making its MRTU Release 2 filing, addressing the potential benefits of including this element.

**FERC MANDATED – file report prior to RELEASE 2**

### **2.2.20 Modeling Constraints of Combined Cycle Units**

In MRTU Release 1 different configurations of a combined cycle unit are modeled collectively as a single resource. The idea here is to model each configuration as a separate resource, and incorporate software capability to ensure changes in configuration during different scheduling and commitment cycles in the course of the optimization process respect all relevant technical and inter-temporal constraints. This approach is of interest to different ISOs, and the CAISO will be monitoring the work of other ISOs in implementing enhanced functionality. Recognizing the software constraints the CAISO is faced with, FERC's 9/21/06 MRTU Order (Paragraph 573) directs the CAISO to continue working with software vendors to develop an application that will accurately detail the constraints of combined cycle units, and to file tariff language for implementation of such improvements no later than MRTU Release 2.

**FERC MANDATED – RELEASE 2**

### **2.2.21 Treatment of use-limited resources with limited number of hours or start ups**

Use-limited resources accommodated in MRTU Release 1 are those with Energy (MWh) limitations. This issue would explore how to incorporate software capability to accommodate other types of use limitation, including limitation on the number of hours of usage, or the number of start-ups a resource may be used for, during the scheduling horizon. Such an evaluation would also consider whether alternatives exist for this type of functionality, since the combination of start-up time, minimum run time, and minimum down time will inherently limit the number of start-ups for a resource during a day, and the incurrence of start-up costs can cause the market optimization to minimize the number of start-ups per day.

### **2.2.22 Start Up Energy Considered as Instructed Energy During Dispatch**

The current MRTU design (Release 1) will not explicitly recognize the time lapse from unit synchronization to operations at its minimum stable operating unit. Any Start Up Energy, i.e., energy produced during the time interval from synchronization to minimum load, is assumed to be uninstructed deviation. This issue would explore how Start-up Energy might be considered as instructed energy during the dispatch process. Various stakeholders have suggested that some resources may take time to ramp to minimum load, and that better recognition of this start-up ramp would better reflect the imbalance energy needs and reduce uninstructed deviations during resource start-up.

### **2.2.23 Automation of sub-LAP adjustments in step 3 of LAP clearing validation**

As explained in the MRTU Tariff and testimonies, the LAP clearing procedure recommended by LECG and incorporated in MTU Release 1, may under some rare conditions result in unintended inefficiencies. A three-step process was suggested to deal with such rare situations. The third step in this process involves “softening” the constraints imposed by fixed LAP Load Distribution Factors (LDFs) and allowing independent adjustment of nodal loads. A manual process in MRTU Release 1 will accomplish this step. The issue here is to automate this step in the post Release 1 MRTU software.

### **2.2.24 Increase in Number of LAP Zones**

FERC’s 9/21/06 Order on MRTU found that the CAISO’s approach to calculating and settling energy charges for load based upon three LAP zones provides a reasonable and simplified approach for introducing LMP pricing, while minimizing its impact on load. The Order recognized that some areas could experience higher prices under a nodal model, thus making it desirable to soften the distributional impacts of LMP, and also recognized that LMP could create an economic hardship on entities located in load pockets. Accordingly, FERC approved the CAISO’s proposal of three major LAP zones as an acceptable starting point. However, the Order directs the CAISO (Paragraph 611) to increase the number of LAP zones for Release 2, to provide more accurate price signals and assist participants in the hedging of congestion charges.

FERC’s 9/21/06 MRTU Order (Paragraph 614) noted that previous guidance orders had asked the CAISO to consider an eventual move to nodal pricing for load, and directed the CAISO to move to nodal pricing for load in the future.



FERC's 4/20/07 MRTU Order (Paragraphs 314-331) FERC further directed the CAISO to increase the number of LAP zones for Release 2.

### **FERC MANDATED – RELEASE 2**

#### **2.2.25 Partial RA Units**

Comments by RTO Advisors proposed that some generators and LSEs may want to enter arrangements in which some or all of the capacity is designated for meeting RA requirements for a period of time, and then not designated for meeting RA requirements for other periods of time: "The CAISO should study what modifications are required to MRTU to allow these types of arrangements." (See Comments of RTOAdvisors, July 28, 2006 at:

<http://www.aiso.com/1845/18459965461b0.pdf>)

As the CAISO's MRTU implementation has progressed, this feature has been incorporated into Release 1, as stated in section 6.1.3.2 ("Partial Resource Adequacy Resources") of the BPM for Reliability requirements, at:

<http://www.aiso.com/1bfd/1bfde7ef4aae0.doc>

#### **2.2.26 Sale of CRRs in CRR Auctions**

Moved to section 2.8.2.

#### **2.2.27 RUC Self-Provision**

Because of limited interest by most market participants in RUC self-provision feature as a priority for Release 1, the CAISO did not to include this feature in Release 1. However, FERC's 9/21/06 MRTU Order (Paragraph 172) directs the CAISO to continue to work with market participants on this issue, and to provide reasons for the inclusion or exclusion of RUC self-provision no later than MRTU Release 2.

### **FERC MANDATED – Provide reasons for inclusion or exclusion by RELEASE 2**

#### **2.2.28 Two-Tier rather than single-tier Real-Time Bid Cost Recovery Allocation**

The existing Real-Time BCR cost allocation for Release 1 of MRTU consists of a single tier charge that is allocated to Measured Demand. In the September 21 Order FERC ordered the CAISO to file tariff language. Stakeholders raised concern regarding the single tier approach and have requested that the CAISO implement a two tier charge similar to Day-Ahead Bid Cost Recovery where the first Tier would allocate costs based on cost causation principles.

In the FERC April 20<sup>th</sup> Order the CAISO was directed to work with stakeholders to develop a proposal for two-tiered allocation of real-time bid cost recovery costs that could be included in MRTU Release 2.

### **FERC MANDATED – RELEASE 2**

## **2.3 Seams and Regional Issues**

This topic area includes initiatives to improve coordination between the CAISO and neighboring control areas, expand markets for import and export of energy and capacity, and support the continuing development of effective energy markets across the western region.

FERC's September 21 Order on MRTU discussed seams issues and directed FERC staff to convene a technical conference in the western region specifically to identify and find solutions for any seams issues alleged to be created or exacerbated by MRTU. The technical conference was scheduled for December 14-15, 2006, in Phoenix. The CAISO participated in this conference. Shortly before this conference, a Seams Issues Subcommittee (SIS) began to meet, and set out an agenda of multiple items for consideration, many of which initially concerned potential impacts of MRTU. Both the technical conference and SIS meetings to date have concluded that while there are several pre-existing issues in which better integration of regional markets can occur, they do not result from MRTU and are not obstacles to MRTU's implementation. As these issues are addressed in SIS and similar forums, this section 2.3 will be updated as appropriate.

### **2.3.1 Import and Export of Intermittent Resources**

Across the western region there are specific locations where intermittent resources such as wind can be operated most productively, but these locations are not necessarily inside the control areas that can fully utilize such generation. Moreover, some areas that may not contain highly productive intermittent resource locations are still subject to renewable portfolio standards. It is necessary, therefore, to develop principles and procedures for importing and exporting the energy from intermittent resources in a manner that reflects the unique operating characteristics of these resources. This activity spans multiple functions of the CAISO and other organizations, including the Renewables Roadmap discussed in section 3.3, and infrastructure-related initiatives, as well as market initiatives. This activity also includes collaborative work among the western states' and federal agencies' wind sharing initiatives. Because of the variability of intermittent resources, the market-related aspects have overlapping issues with section 2.3.8, "Dynamic Scheduling (Import and Export) for Load and Generation".

### **2.3.2 Interchange transactions after the Real Time Market**

This item will explore ways to allow SCs to schedule bilateral import and export transactions with the CAISO after the close of the Real Time Market at T-75 minutes, in situations where the needed import and export transmission capacity is available. Although some interchange transactions would not be fully dispatchable, this topic has overlapping issues and would be coordinated with section 2.3.8.

### **2.3.3 Import and Export of Ancillary Services**

This item will consider ways to expand the ability to import and export reserves, and to clearly define the relationship between Energy schedules on interties and the associated ancillary service requirements.

SCE suggests that interruptible imports bidding into the CAISO market should be charged for the additional Operating Reserve. SCE comments that "...prior to allowing non-firm import sales in any future Release, the CAISO must, at a minimum, have systems in place, which charge the non-firm imports for their associated AS." (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.aiso.com/1845/18459b7a4f300.pdf> )

Additional aspects of this issue are raised by a requirement in the MRTU design that was stated in FERC's 9/21/2006 decision to conditionally approve the MRTU tariff. This requirement is that export schedules that are not supported by RA resources should have equal scheduling priority as Demand within the CAISO control area, and the CAISO has implemented this requirement in Release 1. In doing so, the CAISO has recognized additional issues, including whether the requirement for the non-RA resources to bid into the CAISO market should extend past the Day-Ahead market, and whether there should also be an obligation to offer ancillary service bids. Alternatively, a scheduling option for a "unit contingent" exports could resolve questions about ancillary service requirements for these high-priority exports.

The CAISO will provide a preliminary issue paper to further define these issues.

### **2.3.4 Improve Tagging Procedures and Functionality**

This item will consider methods to better integrate and streamline the process of producing market schedules and tagging such schedules. By eliminating duplicate information that exists in market schedules and tags it may be possible to streamline the control area check-out process and eliminate market schedule and tagging inconsistencies that can have reliability impacts. By using tag information such as the physical source and physical sink it may be possible to expand upon the benefits of the Full Network Model by modeling the flow effects of the interchange schedules.

The CAISO has already acted to request information in tags that identifies the physical source and sink, through Operating Procedure S-313, "NERC Tagging Requirements", at:

<http://www.aiso.com/docs/2002/04/26/200204261503156164.pdf>

However, improved support of regional congestion management would result from further standardization in WECC of identifying physical sources, and from integration of the tagging process within the CAISO's market processes instead of relying on tags as confirmations of market schedules. This would be coordinated with the effort described in section 2.3.5, "Exchange of Day-Ahead Scheduling Information".

### **2.3.5 Exchange of Day Ahead Scheduling Information**

The CAISO will work with other control areas in the west to establish day-ahead exchange of scheduling information, to allow coordinated day-ahead congestion management and to reduce the magnitude of unscheduled loop flows in real time by capturing a major portion of such flows in the day-ahead process. The CAISO is an active participant in the WECC Seams Issues Subcommittee (SIS). Pending the development through SIS of a process for coordinated Day-Ahead congestion management, the CAISO is pursuing improvements in its coordination with individual neighboring control areas, through the Interconnected Control Area Operating Agreements that the CAISO has with most of these areas. These commitments are stated in the CAISO's January 16, 2007, "Post-Technical Conference Comments on Seams Issues of the California Independent System Operator Corporation", which are available at:

<http://www.aiso.com/1b69/1b69af1156ac0.pdf>

The CAISO has added transmission facilities in neighboring control areas to the CAISO's network model in cases where the CAISO has determined through optimal power flow studies that doing so increases the accuracy of congestion management within the CAISO control area, and has also developed software functionality in Release 1 for modeling embedded and

adjacent control areas for which adequate information is available to the CAISO to support these models. The CAISO will be issuing white papers describing these features.

Finally, it is notable that the recently adopted NERC standard TOP-005-1, "Operational Reliability Information", establishes requirements for Balancing Authorities and Transmission Operators to provide to other Balancing Authorities and Transmission Operators with immediate responsibility for operational reliability, the operating data that are necessary to allow them to perform operational reliability assessments and to coordinate reliable operations. As this information exchange, the CAISO expects that it will facilitate improvements to the CAISO's congestion management. This standard is at:

[ftp://www.nerc.com/pub/sys/all\\_updl/standards/rs/TOP-005-1.pdf](ftp://www.nerc.com/pub/sys/all_updl/standards/rs/TOP-005-1.pdf)

### **2.3.6 Dynamic / Pseudo Tie Imports**

Increasingly, dynamic scheduling and pseudo-tie scheduling arrangements are being proposed and implemented. As different versions of these arrangements are proposed, the impact to the market design is evaluated and recommendations made regarding the implementation of such arrangements. In addition, as the new arrangements are implemented, monitoring is performed to ensure the dynamic and pseudo-tie scheduling arrangements are operating as expected. This topic will be discussed further under section 2.3.8.

### **2.3.7 Maximizing Intertie Transfer Capability**

BPA identifies this issue as a way to enhance reliability, market competitiveness, and system efficiency: "Highest priority should be coordination of ATC calculations, outages, and curtailments to maintain transfer capability. Creating opportunities for secondary marketing of unused capacity is another priority, including using any available intertie rights (not just PTO rights) to reach CAISO markets and participants."

BPA's comments are located at:

<http://www.caiso.com/1845/184597e041d00.htm>

### **2.3.8 Dynamic Scheduling (Import and Export) for Load and Generation**

NCPA's comments suggest this market initiative issue for consideration. (See NCPA Comments, July 28, 2006 at:

<http://www.caiso.com/1845/18459bee52990.pdf> )

A dynamic intertie schedule is one that can be dispatched by the CAISO on the same 5-minute intervals that apply to generation within the CAISO control area, or that have specific arrangements between control areas for other forms of sub-hourly dispatch. In contrast, traditional intertie schedules are hourly schedules, which change between hours using established ramping schedules that are common throughout WECC. As noted in sections 2.3.1, 2.3.2, and 2.3.6, as well as in this section 2.3.8, topics have arisen that involve changes in intertie schedules at intervals that are more frequent than traditional hourly interchange schedules.

In the April 2004 filing of Amendment 59, footnote #7, the CAISO offered the potential for a pilot program. A pilot program provides practical experience and aids in the development of formal policy, standards and Tariff provisions, if deemed appropriate. MRTU Release 1 supports dynamic imports, as documented in the BPM for Market Operations. MRTU Release 1 also supports "pseudo ties" for both import and export; this is a variation in which a specific resource,

that is located within one control area, is established through contracts as being part of another control area for purposes of control area operations.

The CAISO and SMUD have included provisions in the Interconnection Control Area Operating Agreement (ICAOA), that allows a dynamic scheduling export pilot program. The Sutter power plant, which is connected to the Western Area Power Administration's transmission system in the SMUD control area, is operated as a "pseudo-tie" such that Sutter is considered to be part of the CAISO control area and uses transmission service through the Western transmission system. Similarly, the New Melones power plant, which is connected to the PG&E transmission system within the CAISO control area, is operated as a "pseudo-tie" such that it is considered to be part of the SMUD control area and uses ETC rights through the PG&E transmission system.

Dynamic exports are less common. If a market participant identifies a specific need to create a dynamic export from the CAISO control area, the CAISO will work with that market participant to determine the best arrangement to meet the identified needs.

## **2.4 Current Market Issues (Pre-MRTU)**

This initiative will monitor existing market performance and regulatory policy developments to identify what if any existing market issues need to be resolved prior to the implementation of MRTU. In order to conserve and focus resources to meet the MRTU initiative, Pre-MRTU issues will be evaluated in terms of impact and effort to ensure only those issues that have the most impact and least amount of effort will be considered for resolution. Some market issues that are identified as part of this initiative may be recommended for resolution as part of future releases of MRTU.

### **2.4.1 Forward Price and Real-Time Price Convergence**

This initiative will identify the sources of apparent systematic differences between the forward bilateral index prices for energy and the CAISO real-time market price, will assess the impacts of such differences and explore possible approaches to improve price convergence.

### **2.4.2 Scheduling Accuracy**

This initiative will continue to monitor the impact scheduling accuracy is having on reliable grid operation and market efficiency. As part of this initiative the CAISO will perform an evaluation of the impact the 95-percent scheduling rule is having on the market.

### **2.4.3 Operating Reserve Procurement**

This initiative was originally identified to evaluate the pre-MRTU impacts of proposed new WECC operating reserve policy. WECC's process of considering changes to how operating reserve should be calculated with regard to each type of interchange schedule (firm, non-firm, unit-contingent) is ongoing at this time. As this effort progresses, the CAISO will determine its requirements under new standards that may be adopted.

### **2.4.4 Payment Acceleration**

SCE and RTOAdvisors suggest the on-going effort to reduce the amount of time for settlement reconciliation should be included as a market initiative issue.

“SCE has not seen a CAISO process to actually implement payment acceleration assuming an MRTU implementation of November 2007. If payment acceleration is still expected to be implemented six months after Release 1, the CAISO must refocus attention on this issue.” (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.caiso.com/1845/18459b7a4f300.pdf> )

“This is not a Post Release 1 issue, but should be included in the category, “Current Market Initiatives (pre-MRTU). We urge the CAISO to add this to the list of active Market Initiatives and to discuss progress on this effort at future meetings.” (See Comments of RTOAdvisors, July 28, 2006, at:

<http://www.caiso.com/1845/18459965461b0.pdf> )

#### **2.4.5 System for Reporting Outages and Derates**

SCE comments that the current system for reporting unit outages and derates is inadequate for participants with large generation portfolios.

“Simply put, the current outage reporting systems are insufficient to implement settlement functions related to either UDP or for unit derate reporting. Thus, prior to the CAISO implementing settlements or penalties for UDP or unit derate reporting, the current SLIC reporting systems must be enhanced or replaced.” (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.caiso.com/1845/18459b7a4f300.pdf> )

The CAISO notes that a stakeholder process is underway to explore alternatives that can be utilized to establish an appropriate explicit minimum megawatt threshold for the outage reporting. This stakeholder process will also provide an additional opportunity to further clarify and respond to any additional questions or concerns Market Participants may have with reporting requirements.

More information on this stakeholder process can be found on the CAISO website at

<http://www.caiso.com/1c27/1c27cfda27310.html>

#### **2.4.6 Multiple SCs at a Single Meter**

On June 7, 2006, FERC issued an order directing the CAISO to address the current prohibition on the use of multiple Scheduling Coordinators at a single meter. On July 12, 2006 the CAISO posted a White Paper identifying various options for dealing with this issue. The White Paper is located at:

<http://www.caiso.com/1832/1832c86e1ade0.pdf>

The City of Riverside has commented that full-scale implementation of the capability of multiple SCs in bidding, operation and settlement would be desirable.

SCE suggests the CAISO should consider redirecting its limited staff to focus on other issues such as MRTU (Release 1) implementation.

Pursuant to the CAISO’s compliance filing on September 7, 2006, the FERC noted that at this point there is minimal stakeholder interest for pursuing an immediate software solution for the “Multiple SC at a Single Meter” issue. The CAISO’s “Ranking Criteria” will be applied in the future to help determine the priority of issues to be developed further and implemented after MRTU Release 1.

## 2.5 Reliability Products

The focus of this initiative is to determine how the CAISO can meet its needs for reliability products and services in the most efficient manner, utilizing market mechanisms where effective. In the course of this assessment the CAISO will also consider whether new products or services should be defined to meet reliability needs that are not fully met by existing products. The following products have been identified to date.

### 2.5.1 Voltage Support and Black Start Procurement

This project is a re-appraisal of procurement methods for these two services, pursuant to the CAISO's compliance filing to FERC (ER98-3760-012) under Docket ER98-3760. This activity is independent of MRTU, but will be coordinated with that project. The CAISO presented papers on these topics during a stakeholder conference call on June 29, 2006, which are available at:

<http://www.aiso.com/181c/181ca4c9731f0.html>

These papers concluded that there is a wide variety of procurement and cost allocation methods among markets around the world, and that further studies could consider a range of future options.

### 2.5.2 Frequency Responsive Reserve (FRR)

Recently the WECC Compliance Monitoring and Operating Practices Subcommittee ("CMOPS") proposed the definition of a new Ancillary Service, Frequency Responsive Reserve ("FRR"), which will have one-minute response capability. An estimate is that 3200 MW of this reserve will be needed in the west, of which 750-800 MW will be needed within the CAISO Control Area. If approved ultimately by WECC, the CAISO will need to determine the most effective way to procure this service and develop the appropriate procurement mechanism. At the June 2007 WECC Board of Directors meeting adopted a proposal by the WECC Operations Committee for a regional criterion to provide for Western Interconnection-wide field testing of the FRR concepts, whose intent is data collection and data analysis, and which expires in September 2009 unless it is extended by the Operating Committee.

As this effort progresses, the CAISO will determine its requirements under this standard.

## 2.6 Specially Situated Participants

This area includes initiatives targeted to entities whose special circumstances or needs warrant some sort of special provisions.

SCE offers the general comment that "MRTU will continue to have 'Phantom Congestion' because of disparate treatment of transmission. SCE views uniform transmission as an important goal for the CAISO and encourages the CAISO to strive for that result." (See SCE Comments on Market Initiatives, July 28, 2006, at:

<http://www.aiso.com/1845/18459b7a4f300.pdf>

### 2.6.1 Metered Subsystems

Currently Metered Subsystems (MSS) have the capability to participate in the CAISO Markets, but tend not to participate fully: (1) to keep their reserves available for load following, (2) to prevent their generating units from being dispatched to serve other entities' demand and risk leaving the MSS short to serve their own demand, and (3) tax exempt status of bonds used to

fund the construction of the generating units to serve their municipal customers could be lost if the resources' energy is sold to parties other than their intended customers. One objective of the CAISO is to encourage MSS to participate more fully in the CAISO Markets.

To encourage greater MSS participation in the markets, the CAISO may perform analyses to assess the nature and level of risks for MSS participating in the markets, and to estimate the magnitude of lost opportunities for MSS who elect not to participate in the markets for each combination of MSS elective options (i.e., load following versus non-load following, net versus gross settlement, etc.). The CAISO will also examine the costs to the CAISO and to non-MSS Market Participants (e.g., via GMC) to accommodate MSS entities.

At the same time the CAISO will continue to work to ensure that the MSS entities are fully integrated into MRTU Release 1 and subsequent releases. FERC's MRTU Order addressed a number of MSS issues, several of which the CAISO was able to address directly in the 60-day compliance filing on November 20. There are some other issues, however, that will be the topic of stakeholder discussion in the next few months and will culminate in additional tariff language on MSS being filed by the CAISO in the first half of 2007.

### **2.6.2 ETC and Converted Rights Holders**

No CAISO initiatives are identified at this time.

### **2.6.3 Transmission Ownership Rights**

Arrangements with parties holding Transmission Ownership Rights (TOR) are currently under development.

### **2.6.4 Dynamic Scheduling of Exports**

This topic has been merged into section 2.3.8, "Dynamic Scheduling (Import and Export) for Load and Generation".

## **2.7 Financial Initiatives**

### **2.7.1 GMC Under MRTU**

On July 26, 2006 the CAISO filed with FERC a request to extend the current GMC settlement until the earlier of MRTU implementation or December 31, 2007 with one change to eliminate a single rate applied to the Modesto Irrigation District. No protests were filed. On September 6, 2006, FERC approved the CAISO request by letter order.

Since September 2006, the CAISO has been working with stakeholders on the GMC rate structure under MRTU. Stakeholders and the CAISO have agreed on a set of GMC rate structure elements that will allow SaMC programming to begin, while providing a structure by which analysis of impacts can be performed over the coming months. The GMC rate structure under MRTU will be discussed at the October 2007 CAISO Board of Governor's Meeting and will be filed with FERC by October 31 2007.

### **2.7.2 Credit Requirements For CRR Holders**

With the introduction of obligation CRRs in MRTU, the CAISO Market Participants may obtain negative valued CRRs, which would have financial obligations in the CAISO day ahead market. If the holder of a negative valued CRR defaults, that would create a financial risk for the rest of



the CAISO market participants. To minimize the risk of payment default by the negative valued CRR holder, collateral amounts will be required. CAISO will develop proposals to determine the collateral amount for the owners of negative valued CRRs.

This topic will cover both the initial year of MRTU when historical LMP data is not available to assess credit requirements, as well as subsequent years of MRTU when historical data is available. The stakeholders most directly affected by this initiative will be those who hold CRRs, regardless of how those CRRs were obtained, i.e., through allocation, through the CAISO auction, or through bilateral trades in the secondary market.

The CAISO has developed its CRR credit policies through a stakeholder process, for which the CAISO's documents and stakeholder comments are available at:

<http://www.caiso.com/1b8c/1b8cdf25138a0.html>

The CAISO's credit requirement policies for CRRs are described in the Business Practice Manual on Credit Management.

## 2.8 Congestion Revenue Rights<sup>4</sup>

This section describes enhancements to the CAISO's rules and systems related to Congestion Revenue Rights (CRRs), including both short-term (i.e., one-year Seasonal and Monthly) CRRs as well as Long Term CRRs. The enhancements generally fall into two categories: those which FERC has ordered or the CAISO has already committed to implement for CRR Year Two,<sup>5</sup> and those which are candidates at this time to be considered for implementation in CRR Year Two or at a later time. At this time the CAISO expects to implement enhancements 2.8.1, 2.8.2, and 2.8.3 for CRR Year Two.

### 2.8.1 Increased MW Granularity of CRR Tracking

The CAISO's initial implementation of the system for tracking CRR holdings cannot track CRR MW quantities smaller than 0.1 MW. Recent changes to some of the CRR rules – particularly the rules for CRR transfers to reflect load migration and for disaggregating CRR nominations sourced at Trading Hubs in the allocation process – have created a need for finer granularity in the CRR tracking system. The CAISO has already committed to correcting this limitation for CRR Year Two, and FERC's July 6 Order affirmed that if the CAISO is unable to correct this limitation within six months after the start of MRTU (which is approximately when the CRR Year Two CRR process will begin), the CAISO must make a compliance filing explaining why this modification could not be made.

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<sup>4</sup> This section of the Roadmap was previously called "Long-Term Transmission Rights." The title and scope of the section are being changed with this edition of the Roadmap to reflect significant CAISO FERC filings and FERC orders that have occurred since the earlier edition, in particular the CAISO's January 29, 2007 Long Term CRR compliance filing and FERC's July 6, 2007 Order on CRRs (see documents posted at <http://www.caiso.com/1845/1845dca750770.html>). As a result it is appropriate to have a CRR section of the Roadmap that encompasses both short-term (Seasonal and Monthly) as well as Long Term CRRs.

<sup>5</sup> The term "CRR Year Two" refers to calendar 2009. On an ongoing basis the annual CRR process for the release of one-year Seasonal and Long Term CRRs to be effective at the start of the upcoming calendar year will be conducted starting several months in advance of January 1 of each calendar year, as specified in the Business Practice Manual for CRRs.

## 2.8.2 Sale of CRRs in the CRR Auctions

The CRR systems for CRR Year One do not have functionality to allow a party to offer for sale in a CAISO CRR auction some of the same CRRs that were previously awarded in an auction or allocation process. The systems do allow the party to engage in a financially equivalent transaction, but this equivalent transaction results in the party holding two equal and opposite CRRs that net out financially, rather than allowing an actual transfer of the original CRR. For example, if the party holds a CRR of 10 MW from source A to sink B and wants to sell that CRR in a CAISO auction, under the CRR Year One functionality the party cannot offer to sell that exact CRR, but must offer to buy at a negative price (assuming the original A to B CRR has positive expected value) a CRR of 10 MW from source B to sink A. If this offer clears the auction, the party ends up holding two 10 MW CRRs, one from A to B and another from B to A, and receives payment for the negative auction clearing price of the B to A CRR which should be the same as the price the party would have received for selling the A to B CRR at a positive price.

Of course, the party also has the option of selling the original A to B CRR bilaterally and then registering the bilateral transaction in the CAISO's Secondary Registration System, but several parties have previously indicated in the stakeholder process that the ability to offer CRR holdings for sale in a CAISO auction process would enhance the efficiency of the CRR market. FERC's September 21, 2006 MRTU Order affirmed that it would be useful to have this feature, and the CAISO has planned to consider this functionality among the enhancements to the CRR systems for CRR Year Two. The September 21 Order directs the CAISO to file tariff language to implement the ability to sell CRRs in the CRR auctions no later than MRTU Release 2.

## 2.8.3 Multi-period Optimization Algorithm for Long Term CRRs

When the CAISO performs the initial release of Long Term CRRs for the period 2008-2017, the Simultaneous Feasibility Test (SFT) optimization will treat the entire 10-year time horizon as a single time period (for each combination of Season and Time of Use period) with respect to network model assumptions. For CRR Year Two and beyond, the CAISO has recognized that a multi-period algorithm can result in a more optimal allocation of Long Term CRRs because it would be able to reflect different assumptions for each year regarding the availability of grid capacity for CRRs, in particular the known expiration of previously released Long Term CRRs, Existing Transmission Contracts and Converted Rights. The CAISO has committed to explore this enhancement for CRR Year Two, and FERC's July 6 Order affirmed that if the CAISO and its stakeholders choose to implement the multi-period algorithm, the CAISO must make a compliance filing within 30 days explaining the reasons for the change, how the change will affect Long Term CRR nominations, and how the change has been tested.

## 2.8.4 Software for Bundling Individual PNode CRRs into Trading Hub CRRs

The rules for handling CRR nominations sourced at a Trading Hub in the allocation process use a "disaggregation" approach whereby such nominations are disaggregated or unbundled into individual Point-to-Point CRRs each of which has as its source a Generating Unit PNode that is a constituent of the Trading Hub. Such nominations are then submitted to the optimization and eventually awarded to the nominating LSE in the unbundled form. Although the CRR Sources in the awarded "bundle" are expected to closely resemble the composition of the Trading Hub, they will in general not match the Trading Hub exactly. FERC's July 6 Order directed the CAISO to consider whether to develop software to assist LSEs in the trading of Trading Hub CRRs by "rebundling" individual PNode CRRs to reconstitute a Trading Hub CRR. More generally the

CAISO is also required by the Order to make a compliance filing within 6 months after the start of MRTU that explains whether the disaggregation method remains appropriate.

### **2.8.5 CRR Source Verification After CRR Year One**

The current MRTU tariff provides for CRR source verification in conjunction with CRR allocation to LSEs serving internal load only for CRR Year One. FERC's July 6, 2007 Order on CRRs encourages the CAISO to consider implementing some form of source verification process in CRR Year Two and beyond.

### **2.8.6 Flexible Term Lengths of Long Term CRRs**

FERC's July 6, 2007 Order on CRRs encourages the CAISO to consider future flexibility to allow: (i) Long Term CRRs in excess of 10 years, or (ii) annual CRRs with guaranteed renewal rights up to year 10, or (iii) Long Term CRRs with terms ranging from 2 to 9 years. FERC notes that any subsequent change in the available term lengths would have to respect the rights of the holders of any outstanding 10-year CRRs.

### **2.8.7 Long Term CRR Auction**

The CAISO's January 29, 2007 compliance filing on Long Term CRRs noted that several parties wanted the CAISO to implement an auction process for Long Term CRRs, which the CAISO agreed to consider for a future release. FERC's July 6, 2007 Order on CRRs encourages the CAISO to initiate the stakeholder process and file tariff language to implement an auction for residual Long Term CRRs in MRTU Release 2.

### **2.8.8 Release of CRR Options**

FERC's July 6, 2007 Order on CRRs urges the CAISO to continue exploring the feasibility of implementing option CRRs in a subsequent MRTU release.

## **3. Supply Adequacy Initiatives**

The broad area of Supply Adequacy includes primarily activities in which the CAISO is a participant but does not play a lead role, although in most activities the CAISO does have very specific and essential roles and responsibilities. In addition most – but not all – of the initiatives included in this area fall under state or local regulatory jurisdiction rather than under FERC jurisdiction.

### **3.1 Near-term (2006) Resource Adequacy**

The CAISO and CPUC have been engaged in separate but related efforts to establish a regulatory framework to ensure that adequate capacity is committed in a forward time frame to allow the CAISO to operate the grid reliably. In the CPUC arena this effort is called "Resource Adequacy," and it is implemented through CPUC Decisions issued in 2004, 2005, 2006 and 2007 that establish Resource Adequacy Requirements that became effective June 1, 2006. The CAISO continues to develop complementary resource adequacy requirements within its tariff which were originally established through a tariff filing (the Interim Reliability Requirements Program) that was filed at FERC on March 13, 2006 and accepted with relatively minor modifications on May 12, 2006. In addition the CPUC, issued a decision on June 29, 2006 that formally established locational capacity requirements for load serving entities under its jurisdiction to become effective in 2007 and most recently, on June 21, 2007 the Commission

established a zonal RA implementation proposal that effectively addressed the CAISO's zonal capacity needs.

At a high-level, the "Near-term Resource Adequacy" activities consist of staff from the CAISO, CPUC and CEC working together to implement the on-going regulatory framework established by the CPUC Decisions and the FERC Order. Staff from the CPUC, CEC and CAISO coordinates weekly, if not more often, to ensure effective implementation and refinement of the CPUC's resource adequacy program.

## 3.2 Long Term System Security

The larger share of activities that will ultimately support Long Term System Security are being conducted under the procedural umbrella of the CPUC's Long Term Procurement Plan (LTPP) Rulemaking. This CPUC rulemaking includes the Phase 1 and Phase 2 Resource Adequacy proceedings as well as several more narrowly focused activities such as the Demand Response proceeding, all of which are discussed in the next four sub-sections, the first of which provides an overview of the entire Long Term Procurement Plan Rulemaking. The final two sub-sections describe Long Term System Security initiatives that are closely inter-related with the CPUC's LTPP Rulemaking but are led by the CAISO.

### 3.2.1 CPUC Long Term Procurement Plan Rulemaking

On February 16, 2006, the CPUC issued its Order Instituting Rulemaking ("OIR") for Long Term Procurement Plans (R.06-02-003). This new proceeding functions as the umbrella rulemaking for all other procurement related proceedings at the CPUC. It encompasses all phases of the CPUC's Resource Adequacy proceeding, including Phase 1 and Phase 2 described below, as well as the original Resource Adequacy proceeding conducted in 2004-2005. In its OIR the CPUC describes this Rulemaking as follows:

*The primary purpose of this rulemaking is to serve as the Commission's forum to integrate all procurement policies and related programs. A key representation of this integration is the filing, review and adoption of long-term procurement plans by the IOUs. These plans will cover the period 2007 to 2016 and they will reflect all of the decisions made by the Commission since the last filing of long-term plans. In addition, this rulemaking will seek the participation of ESPs [retail Electric Service Providers] and CCAs [Community Choice Aggregators] as contributors to the state's long-term resource planning process. ...This rulemaking will serve as an umbrella proceeding to handle the procurement policy issues that do not warrant a separate rulemaking and it will provide a place to integrate all of our efforts ongoing in the other procurement related dockets, including:*

1. *Community Choice Aggregation (R.03-10-003);*
2. *Demand Response program plans (A.05-06-006 et al.);*
3. *Critical Peak Pricing (A.05-01-016 et al.);*
4. *Distributed Generation (R.04-03-017 and its successor);*
5. *Energy Efficiency (R.01-08-028 and its successor);*
6. *Avoided Cost and Qualifying Facility (QF) Pricing (R.04-04-025);*
7. *Renewable Portfolio Standards (R.04-04-026 and its successor);*

8. *Transmission OII, I.00-11-001; and Renewable Energy Transmission (I.05-09-005);*
9. *Confidentiality (R.05-06-040); and*
10. *Resource Adequacy Requirements (R.05-12-013).*

*This rulemaking will host any other procurement policy issues that need to be addressed by the Commission in a comprehensive or integrated fashion.*

Consistent with previous CAISO Board directives, the CAISO is supporting the CPUC in this Rulemaking to ensure that the objectives and outcomes of the various phases are aligned and an appropriate mix of resources is procured, in the right geographic areas, in adequate amounts to operate the grid reliably.

The LTPP Rulemaking has been separated into two phases (which are distinct from and not to be confused with the two phases of the Resource Adequacy Proceeding, discussed in Sections 3.2.2 and 3.2.3 below). In LTPP Phase 1 the CPUC reviewed the need for additional policies to support new generation and long-term contracts in California, including possible transitional and/or permanent mechanisms (e.g., cost allocation and benefit sharing, or some other alternative) which can ensure investment in and construction of new generation in a timely fashion. In Phase 2 the LTPP Rulemaking will serve as the forum for the CPUC's biennial procurement review process, established pursuant to AB57, D.04-01-050 and D.04-12-048, which requires that investor-owned utilities submit long-term procurement plans that serve as the basis for their procurement, and will comprehensively integrate all CPUC decisions from all procurement related proceedings. The CAISO is expected to take an active role in the review of these plans to provide insight as to their ability to provide the necessary portfolio of resources that can reliably serve the load in the CAISO control area.

### **3.2.2 CPUC Phase 1 Resource Adequacy (Completed)**

Phase 1 of the CPUC Resource Adequacy proceeding (R.05-12-013) was a continuation of the state's program to ensure reliable and cost-effective supply in California through augmentation of the CPUC's previously adopted program of resource adequacy requirements ("RAR") in R.04-04-003. Central to Phase 1 of this Resource Adequacy proceeding was the establishment of a local capacity requirement that is to be implemented through the RAR program in 2007 for CPUC-jurisdictional load-serving entities (LSEs). This phase is now complete and a final decision was issued by the CPUC on June 29, 2006.

### **3.2.3 CPUC Phase 2 Resource Adequacy**

Initiated in late summer 2006, Phase 2 addresses a number of new topics as well suggested improvements to the current program. New topics include significant issues such as the institution of a capacity market and a zonal capacity requirements obligation on load-serving entities.

On December 15 2006, the CPUC issued a scoping memorandum that stated that the question of whether to implement a Capacity Market is a Track 2 item, and a decision on Track 2 items will be made in early 2008

The CAISO is currently engaged in a stakeholder initiative to evaluate centralized capacity market (CCM) designs to aid in the decision of whether a CCM is an appropriate element of a long term Resource Adequacy (RA) plan. Pursuant to a May 25 California Public Utilities Commission (CPUC) Assigned Commissioner Ruling (ACR), this effort is carefully being

coordinated with the Energy Division Staff at the CPUC to ensure that the CPUC's consideration of proposals for CCM options is fully informed by the CAISO's concerns and expertise.

The CAISO will use its stakeholder process to (1) evaluate alternative CCM options with the objective of developing a CAISO recommendation to submit to the CPUC, and (2) to build consensus around a single CCM conceptual design, if possible. The CAISO will include its recommendation in a November 2 Joint Report by the CAISO and the Energy Division Staff in the Track 2 Proceeding.

The CPUC decision on the design of a Centralized Capacity Market is expected in February 2008.

The current Issue Identification Paper can be found on the CAISO website at the following link:

<http://www.aiso.com/1c1e/1c1e8cf363270.pdf>

### 3.2.4 Demand Response

With the heat storm of 2006 and record setting load growth in California and the nation, along with the persistent challenges associated with adding new transmission and generation capacity, policy makers, utilities and customers are taking a renewed interest in demand response as a viable option for meeting future resource needs. Interruptible and load cycling programs have long been effective demand "responsive" resources used by utility operators to maintain reliability, after a system emergency has been declared. However, given deregulation and the spawning of wholesale energy markets, along with the advent of automated, addressable, and dispatchable demand response technologies that can be triggered in very specific and targeted ways, perspectives on demand response applications have broadened. Regulators and policy makers see the potential for demand response to not only enhance the reliability of the grid operator, but to create market efficiencies by adding additional capacity and liquidity to the wholesale energy markets.

The CAISO understood this potential. The CAISO also understood that California was serious about meeting the state's growing energy needs by first lowering demand before increasing supply<sup>6</sup>. Additionally, California is committing millions of dollars on demand response programs, yet both of these efforts are largely disconnected from the CAISO as the grid operator and wholesale market provider.

Understanding that the demand-side represents the "other" economy in the wholesale energy market, the CAISO is working in collaboration with the CPUC, CEC and demand resource providers to advance the integration of demand resources into the CAISO's wholesale market design and grid operations. In this regard, five key demand resource working groups have been formed to help meet this important objective. The five working groups are:

1. Demand Response Participation in MRTU Release 1
  - Lead agency- CAISO

*In the June 25, 2007 FERC Order the CAISO was directed to include in its 60-day status report how it will incorporate demand response within the RUC process by MRTU Release 1 or*

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<sup>6</sup> CPUC and CEC adopted the Joint Agency Energy Action Plan, which among other things, established a goal of 5% price-responsive demand by 2006 and a loading order that gives highest priority to energy efficiency and demand-side resources in the resource procurement priority order of the IOUs.

*explain why such work-arounds cannot be deployed in MRTU Release 1. The Release 1 Working Group is addressing this directive.*

2. Demand Response Participation in MRTU Post Release 1
  - Lead agency- CAISO
3. Demand Resource Product Specification
  - Lead agency- CEC
4. Infrastructure for Demand Resources
  - Lead agency- CEC
5. Vision for Demand Resources
  - Lead agency- CPUC

Each group has specific objectives and resulting deliverables to produce with the over-arching objective being to enable greater participation from demand resources in the wholesale power markets.

### **3.2.5 CAISO Short-term Reliability Service**

In early 2006, the CAISO participated in a joint filing of the Reliability Capacity Services Tariff Offer Of Settlement (“RCST” Settlement), for which most elements are in effect. However, the CAISO and market participants are awaiting a FERC final decision on the price basis for RCST payments. If approved as filed, the RCST Settlement provisions will expire the earlier of MRTU implementation or December 31, 2007. The terms and conditions of the offer contain a modified version of the existing FERC-ordered Must Offer Obligation (MOO) for some units, but this MOO as well as the original MOO are, according to the current MRTU proposal, ending with the implementation of MRTU.

The Resource Adequacy (RA) proceedings of the CPUC are intended to ensure that adequate resources are available to meet the demand and operating requirements of the CAISO. In order to properly meet all projected system conditions, system-wide capacity requirements must be supplemented by local and zonal requirements. Even then, however, there are conditions and circumstances that require supply capacity that was not procured under the RA requirements. The RCST provisions, in combination with the MOO, are expected to provide a mechanism to enable the CAISO to meet such needs. But because these provisions sunset with the sooner of MRTU start-up or the end of 2007, the CAISO must develop a successor mechanism for procuring reliability services on a short-term basis to be implemented at that time.

The CAISO conducted a stakeholder process that concluded in December 2006. The CAISO filed amended tariff language to address RCST for 2007 with FERC on December 15, 2006.

On March 15, 2007, the CAISO submitted tariff sheets to comply with the February 13, 2007 Order on 2007 RCST (2007 RCST Tariff Sheets). As required by that order, the CAISO has modified section 43.2.1 of the CAISO Tariff.

FERC approved the CAISO’s proposed tariff amendments for RCST in the 6/11/2007 Order 119 FERC 61,266.

The relevant FERC orders on this topic can be located at the following locations:

<http://www.aiso.com/1bfb/1bfba41021b90.pdf>

<http://www.caiso.com/1bee/1bee709f50330.doc>

### **3.2.6 Resource Adequacy Requirements for Non-CPUC Jurisdictional Entities**

The CAISO in collaboration with the CPUC and other local regulatory authorities is establishing a framework of requirements to ensure supply sufficiency for the control area. The CAISO has established appropriate tariff based reliability requirements, which include reporting and offer obligations to ensure comparability for all parties. Currently, the CAISO is working with non-CPUC jurisdictional entities to implement the reporting requirements such that these entities are providing the CAISO with critical operating information through a standard template. In addition, the CAISO is working with all stakeholders to review the study assumptions and methodologies employed to determine the locational capacity needs in the CAISO control area. Moving forward, this activity will continue to clarify and refine the obligations and processes that all non-CPUC jurisdictional entities will use in meeting the CAISO reliability requirements.

### **3.2.7 MRTU RA Import Capacity Allocation Methodology**

The CAISO filed an import accounting methodology in its proposed MRTU Tariff on February 9, 2006. However, on March 13, 2006, the CAISO filed its IRRP Tariff, which included a methodology for accounting for import capacity that built upon and was, in critical ways, superior to the language that was included in the February 9, 2006 MRTU Tariff filing. On May 12, 2006, FERC approved the IRRP filing and found the CAISO's proposal for accounting of import capacity for 2007 to be equitable

On March 22, 2007, the California Independent System Operator Corporation (CAISO) filed a proposal to revise the methodology for assigning transmission import capability into the CAISO Control Area to Load Serving Entities (LSEs) for resource adequacy reporting and compliance purposes (Import Capability Assignment Amendments). Under this methodology, the CAISO proposed an accounting mechanism to assign import capability on the basis of load ratio share while respecting contractual transactions in order to maintain reliability of the CAISO-controlled grid.

The proposal was approved by FERC with some modifications in the May 18, 2007 Order which is posted on the CAISO website at

<http://www.caiso.com/1bee/1bee84ae74c0.doc>.

The CAISO Board documents on this topic are located at:

<http://www.caiso.com/1b94/1b94ded2511d0.html>

### **3.2.8 Renewable Resources**

Consistent with its 2006 Annual Corporate Goals, the CAISO developed a plan for supporting State policy regarding renewable resources. This plan, called the "Renewables Road Map," was provided to the CAISO Board at the June 13-14, 2006 meeting.

The primary goals and objectives of the plan are to integrate renewable resources into the CAISO's transmission planning, markets and operations to support the State's goal of 20



percent of customer load being served by renewable resources by the end of the year 2010; and to identify additional issues and challenges that must be addressed to support the State's ultimate goal of 33 percent of customer load being served by renewable resources by 2020.

The Renewables Road Map can be found through the following web link:

<http://www.caiso.com/pubinfo/BOG/documents/index.html>