GENERAL SESSION MINUTES
California ISO (CAISO)
MARKET SURVEILLANCE COMMITTEE MEETING
June 6, 2007
Folsom, California

Chairman Frank Wolak officially called the meeting to order at approximately 9:00 a.m. with all committee members in attendance in person.

COMMITTEE MEMBERS ATTENDING

Frank Wolak
Jim Bushnell
Ben Hobbs

PUBLIC COMMENT

Rich Mettling of Pacific Gas & Electric urged stakeholders and the MSC to exercise caution in approaching a number of topics to be discussed during the meeting.
Brett Franklin of the Electricity Oversight Board (EOB) asked the MSC to consider whether all of the additional payment mechanisms to generation unit owners to be discussed at the meeting were necessary for the long-term financial viability of the California electricity supply industry.

GENERAL DISCUSSION ITEMS

1. **Market Redesign and Technology Upgrade (MRTU) Load Scheduling Requirement.** Jacqueline DeRosa, of Market and Product Development discussed day-ahead scheduling requirements under MRTU. DeRosa reviewed the FERC directives on day-ahead scheduling requirements under MRTU. FERC requested that CAISO develop and file interim measures to address the incentive that LSEs may have to under-schedule in the day-ahead market. CAISO must submit this filing no later than 180 days prior to the effective date of MRTU Release 1. DeRosa then discussed a CAISO April 22, 2007 issues paper, which presented possible options for addressing LSE under-scheduling. Two of these options were:
    - Comparing the LSE's day-ahead market forecast to the maximum amount that the LSE bid in the day-ahead market, at any price; and
    - Imposing an interim scheduling charge based on the amount of purchases an LSE made in the real-time market.

    After some discussion about these two options, several MSC members questioned the need for an explicit mechanism to prevent under-scheduling under MRTU, noting that the three large LSEs would be expected to continue the practice of having fixed price-forward contract coverage for more than 90% percent of their final demand. The MSC members reasoned that, with a fixed price, the LSEs should be indifferent to the day-ahead price for this 90% plus portion of its demand, and, accordingly, should have little incentive to under-schedule this amount of demand in the day-ahead market, regardless of the day-ahead price.

2. **Conceptual Design for Convergence Bidding.** Margaret Miller of Market and Product Development gave a presentation on the development of the CAISO's conceptual design for convergence bidding. She first provided background on the CAISO's progress to date which included a summary of the key design elements that have been previously reviewed with stakeholders, including explicit identification of virtual bids and restricting the convergence bids to the LAP level.

Miller also discussed issues that were in need of further stakeholder discussion. These include: which uplift and unit commitment charges are allocated to convergence bids; credit requirements for virtual bids; and position limits on virtual bids. Miller also presented a proposed timetable for stakeholder meetings to formulate a final convergence bidding proposal.

MSC members suggested that establishing position limits on the amount of convergence bids might be a way mitigate potential harm of allowing node-level bids. In a discussion of the rationale for allocating uplift and unit commitment costs to bids, MSC members differed on whether to treat convergence bids differently or symmetrically to physical bids.

3. **Scarcity Pricing.** Chairman Frank Wolak gave a presentation on scarcity pricing in other markets and how it might work in electricity markets and under MRTU. Wolak emphasized the crucial role that demand response plays in scarcity pricing in other markets. Wolak noted that a major problem with administrative mechanisms to set scarcity prices is that it can be virtually impossible to tell the difference between true scarcity and an artificial scarcity created by suppliers to achieve the conditions necessary to invoke scarcity prices. Wolak noted that an additional benefit of a demand response approach to scarcity pricing would be that it could be used to determine the level of the bid cap in the CAISO's markets.

Shucheng Liu of Market and Product Development discussed the CAISO process for developing a conceptual design for a scarcity pricing mechanism, and noted that FERC had directed CAISO to file tariff language for implementation of a scarcity pricing methodology within 12 months of the start of MRTU. Liu then outlined various design issues for vetting a stakeholder process to develop a scarcity pricing mechanism. Liu noted that the CAISO has posted several issues papers for a scarcity pricing conceptual design and has asked for initial stakeholder comment.

After the presentation, several MSC members urged that the CAISO implement a scarcity pricing mechanism which used final demand in the price-setting process, rather than relying on administratively set prices, as a way to minimize incentives for suppliers to create system conditions that could result in scarcity prices. One MSC member argued that a formal capacity payment mechanism was not a necessary component in establishing scarcity pricing in California.

4. **MRTU Interim Capacity Procurement Mechanism.** Keith Johnson of Market and Product Development discussed the CAISO's proposal to make the current Reliability Capacity Services Tariff (RCST) structure compatible with MRTU. Motivation for this product is to allow the CAISO to procure additional generation capacity when it deems this necessary under standardized terms and conditions. Johnson noted that this mechanism could be replaced by a centralized capacity payment mechanism, should the CAISO decide to pursue that. Johnson discussed the conditions and process that would trigger CAISO procurement of additional capacity. Conditions that would trigger CAISO procurement include LSE failure to meet RA requirements, need for additional local capacity beyond the RA level and occurrence of a significant event which invalidates an underlying assumption of the RA procurement. Johnson also outlined several topics for discussion by stakeholders.

Several MSC members felt that that backstop procurement mechanism which Johnson proposed would function as an upper bound on prices that LSEs would pay for local RA capacity, and cautioned the CAISO not to make the capacity payment mechanism too "generous" or it could operate to raise the prices that the LSE might have to pay to meet their RA requirements.

5. **Update on Demand Response.** John Goodin, of Market and Product Development summarized the current state of demand-response activities at the CPUC and CAISO. There are three components to the CPUC proceeding:
   (1) Establish methodologies for assessing the load impact and cost effectiveness of demand response programs;
   (2) Set demand response goals for 2008 and beyond; and
   (3) Integrate demand response into MRTU.

Goodin stated that workshops are being formed to accomplish these goals and that CAISO will be participating.

Chairman Wolak adjourned the public portion of the MSC meeting at approximately 5:30 pm.