Market Surveillance Committee (MSC) Update

Frank Wolak

Chair, Market Surveillance Committee of California ISO

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MSC Activities

Two major issues

- Raising level of bid cap on real-time energy market
  - Recommend raising $250/MWh soft cap to $400/MWh
- Resource Adequacy Process
  - Contract adequacy for LSEs
  - Meeting local reliability needs
  - Meeting ISO operators' needs

Bid Cap on Real-Time Market

- Significantly higher natural gas prices than when $250/MWh bid cap was initially set in summer 1998
- Potential for variable costs of some units to be near bid cap during winter of 2005-06 or summer of 2006
  - Can reduce supply to California when energy needed most
- Higher bid cap increases incentive for active demand-side participation
- To limit disruption in operation of short-term market, raise bid cap before significant bids above $250/MWh soft cap are taken
- Raise bid cap to level that recovers similar $/MWh payment to capital at current natural gas prices as $250/MWh did at 1998 natural gas prices
  - Yields a $400/MWh soft cap

Bid Cap on Real-Time Market

- Major arguments against raising bid cap during June 2000 to June 2001 are no longer relevant
- All LSEs hedged for virtually all of their load obligations in fixed-price forward contracts or own generation capacity
- During period June 2000 to June 2001, LSEs had virtually no forward contracts except for PX block forwards and own generation
  - An average of approximately 60% of final demand was covered by forward contracts or own generation
  - Percentage coverage even lower during peak hours of the day
- California Public Utilities Commission may approve active demand-side participation in short-term market
  - Higher bid cap can encourage more demand response

Resource Adequacy

- Major lesson of California crisis
  - Adequate fixed price forward contracting necessary for competitive short-term market
    - Both energy and ancillary services
  - Adequate generation capacity need not result in workably competitive short-term market
    - Capacity payments can be extremely costly
- “Missing money” is not a problem if LSEs enter into forward contracts
  - Make sure LSEs purchase necessary energy and ancillary services far enough in advance for suppliers to provide it at least cost

Challenges to RA Process

- To procure necessary locational energy and reserves in forward market
  - Transparent local market power mitigation mechanism for energy and ancillary services necessary
- Must provide ISO operators with resources they need to operate system reliably
- Current CPUC process focuses on prudent procurement in forward market, but allows pass-through of real-time purchase costs to consumers
  - Creates strong incentives for price volatility and congestion in short-term markets
  - Need for incentive regulation of short-term energy and ancillary services purchases by LSEs
- ISO's current proposal for long-term resource adequacy appears to be moving towards addressing these issues