

# Memorandum

**To:** ISO Board of Governors  
**From:** Frank A. Wolak, Chairman, ISO Market Surveillance Committee  
**cc:** ISO Officers  
**Date:** October 9, 2007  
**Re:** *Market Surveillance Committee Activities from August 11, 2007 to September 25, 2007*

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**This is only a status report. No Board action is requested.**

The Market Surveillance Committee (MSC) has worked with ISO staff on several issues and participated in stakeholder conference calls and a stakeholder meeting at the California ISO during the past month. This memo summarizes these activities.

## **Interim Capacity Payment Mechanism**

All three MSC members have been involved in discussions with Market and Product Development staff on design of the Interim Capacity Payment Mechanism (ICPM) to replace the Reliability Capacity Services Tariff (RCST). The ICPM will provide the ISO with a backstop to the California Public Utilities Commission (CPUC) Resource Adequacy (RA) process. If the ISO determines that a load-serving entity (LSE) has not procured its full RA requirement in advance of the delivery year, the ICPM process will allow the ISO to purchase the needed RA capacity and charge this cost to the market participant. The ICPM product also allows the ISO to procure additional RA capacity within the delivery year if a "significant event" occurs during the year that renders the RA requirements set at the start of the year inadequate. A sustained transmission or generation outage could create a circumstance where additional RA capacity is needed during the year.

The major design issues with the ICPM concern the appropriate compensation to be paid to generation unit owners for each type of capacity and the system conditions within the delivery year necessary for the ISO to declare a significant event. The consensus among MSC members is that capacity payments under ICPM that address RA procurement deficits before the delivery year should be higher than payments made within the delivery year to address RA deficiencies stemming from a significant event. The distinction is that procurements before the delivery year are typically attempting to provide incentives for more generation capacity to exist at certain locations in the ISO control area. Procurements within the delivery year have the less ambitious goal of ensuring that existing capacity at certain locations in the ISO control area will continue to be made available to the ISO operators. The price for procurements made before the delivery year should be based on the cost of new entry (CONE) whereas the price for procurements made during the year should be based on the going-forward fixed costs of a generating unit. A number of important modifications to this distinction are necessary to address market power mitigation goals. A second key issue is a process used to designate a significant event. There are two competing tensions in making this designation: (1) the need to provide the ISO with the discretion to purchase additional RA capacity if it

believes reliability is adversely impacted by some unexpected event, and (2) the need to provide as much clarity as possible to the process used to designate significant events so that market participants do not rely on the ICPM process to meet their RA needs. The consensus approach to dealing with these two tensions is for the ISO to maintain substantial discretion to declare significant events and procure additional RA capacity, but only for a short-term period of time. Procurement for a longer period of time can only take place after additional interaction between the ISO and relevant stakeholders.

### **Long-Term Resource Adequacy Process**

**James Bushnell** and **Frank Wolak** participated in the stakeholder meeting on the long-term resource adequacy process on September 19, 2007 at the California ISO in Folsom. The CPUC has asked the ISO to make a recommendation to the CPUC on the design of a centralized capacity market in California. The primary purpose of the September 19, 2007 meeting was to review the capacity market design proposals made by stakeholders in preparation for the ISO making its recommendation to the CPUC. The MSC will also hold a joint meeting with stakeholders on October 1, 2007 at the California Public Utilities Commission in San Francisco to discuss the design of a long-term resource adequacy process for California. There are three goals for this meeting: (1) identify the strengths and deficiencies of the current resource adequacy process, (2) identify remedies for these deficiencies, and (3) determine the tradeoffs between these remedies in the design of a long-term resource adequacy process for California.

### **Scheduling Inter-tie Resources in Adjacent Control Areas under MRTU**

**James Bushnell** and **Frank Wolak** participated in discussions with Market and Product Development staff on scheduling of inter-tie resources in adjacent control areas when the Full Network Model is implemented as part of MRTU. The major concern with this issue is the potential for control areas adjacent to the California ISO control area, with multiple entry and exit points into the California ISO control area, to use their ownership and control of transmission and generation to profit from price differences at inter-ties between their control area and the ISO control area. These discussions identified several metrics for the ISO to monitor to ensure that adjacent control areas were not using their ownership and control of transmission and generation capacity to earn persistent profits from locational price differences.

### **Spinning Reserve Certification**

**Frank Wolak** participated in several stakeholder conference calls and discussed the spinning reserve certification issue with the ISO staff and interested stakeholders. The key issue is that the ISO does not believe that its tariff allows aggregated units to sell spinning reserve beyond the unloaded capacity of the smaller host unit unless the larger combustion turbine is synchronized to the system.

### **Greenhouse Gas Emissions and California Electricity Market**

**James Bushnell** and **Frank Wolak** have continued to meet formally and informally with a number of California parties to discuss the implementation of a Greenhouse Gas Emissions control policy that best utilizes the strengths of the CAISO market design and does not adversely impact the performance of the California and Western Electricity Coordinating Council (WECC) electricity markets.