



Memorandum

To: ISO Board of Governors
From: Frank A. Wolak, Chairman, ISO Market Surveillance Committee
Date: January 27, 2011
Re: *MSC Activities from December 7, 2010 to January 19, 2011*

This memorandum does not require Board action.

The Market Surveillance Committee (MSC) dealt with two major issues during the past month. The first is the extent of divergence between hour-ahead and real-time prices and whether this may have adverse market impacts when convergence bidding is implemented during the first quarter of 2011. The second is the California Independent System Operator Corporation's proposal for regulation energy management resources, which is a mechanism to allow energy-limited resources to participate in the ISO's regulation reserve market.

Price divergence and convergence bidding

Section 2 of the November 8, 2010, Quarterly Report on Market Issues and Performance by the Department of Market Monitoring summarizes the magnitude and possible causes of price divergence between hour-ahead prices and real-time energy prices. This report notes that prices in the hour-ahead market used to settle imports and exports have tended to be systematically lower than prices in the 5-minute real-time market during the third quarter of 2010. MSC members were contacted by staff of the California Public Utilities Commission to discuss how this price divergence could impact the costs to California consumers when nodal convergence bidding is implemented in February 2011. Several conference calls were held with individual MSC members and staff from the CPUC to discuss this issue and evaluate possible mechanisms to limit the extent of price divergence or at least limit its adverse impacts on California's load-serving entities. The general conclusion of these discussions was that the MSC would continue to monitor this issue after the implementation of convergence bidding, to determine if its implementation had exacerbated the extent of price divergence and magnitude of uplift charges that load-serving entities were subjected to.

Regulation Energy Management

The MSC prepared an opinion on the ISO's regulation energy management proposal which provides a mechanism for energy-limited resources to provide regulation up and regulation down. A key component of this proposal is a modification of the 5-minute real-time market to dispatch additional energy to ensure that energy-limited resources have sufficient energy to provide regulation reserve for the entire hour. The MSC's opinion supports the intent of the proposal—to allow energy limited resources to provide regulation reserve. However, the MSC is concerned that the rapid introduction of a substantial amount of regulation energy management capacity into the market could create reliability challenges for the ISO operators. The MSC recommended an extensive monitoring process during the early stages of the implementation of the proposal as a mechanism for addressing these concerns. The MSC also proposed a change in how certain uplift costs were allocated to regulation energy management capacity in order to treat them symmetrically with other energy-limited resources such as pumped storage facilities. A copy of the MSC opinion is included with this memo as Attachment A.