

Memorandum

To: ISO Board of Governors

From: Benjamin F. Hobbs, Chair, ISO Market Surveillance Committee

Date: July 8, 2014

Re: Briefing on MSC Activities from May 9, 2014 to June 30, 2014

This memorandum does not require Board action.

Over the time period covered by this memorandum, the Market Surveillance Committee has been preparing a formal opinion for submission to the Board of Governors at its July meeting. The opinion will address local market power mitigation (LMPM) in the forthcoming energy imbalance market (EIM). The opinion is scheduled to be discussed and adopted during an MSC general session teleconference meeting on July 7, 2014.

The MSC held a general session meeting in Folsom on May 19, 2014 in which the following topics were addressed:

- Market power mitigation in the energy imbalance market
- ISO market prices
- Resource adequacy resource availability incentive mechanism, which is part of the reliability services initiative
- Potential changes to commitment cost pricing to address issues arising from the volatility of natural gas prices

Individual MSC members interacted with staff and stakeholders on these initiatives as well as on the development of a methodology to assess the benefits and costs to market participants of participating in the EIM. The MSC is planning to prepare and submit formal opinions on other ISO initiatives for the Board of Governors at subsequent meetings. These include initiatives on reliability services, the flexible ramping product, and commitment costs enhancements. The MSC will hold a general session meeting in Folsom on August 20, 2014 in which those topics will be addressed.

The next section provides a summary of what was discussed at the MSC general session meeting of May 19 followed by a summary of the issues to be addressed in the forthcoming MSC opinion on LMPM in the energy imbalance market.

MSC General Session Meeting of May 19

MSC members made several presentations and led discussions with staff and stakeholders during this meeting.

Two presentations were made by ISO Department of Market Monitoring staff, led by Director Dr. Eric Hildebrandt, on general and technical issues involved in market power mitigation in the EIM.¹ These presentations and ensuing discussions with stakeholders and staff have been highly helpful as we prepare our opinion on the topic for submission to the Board of Governors.

Dr. Scott Harvey, member of the MSC, presented an updated version of his April 22, 2014 ISO Market Forum presentation, which addressed the sources and consequences of uplift payments in the ISO spot markets.² Dr. Harvey discussed the possible implications of growing solar and wind penetration for future sources and amounts of uplifts.

Ms. Carrie Bentley, Senior Market Design and Policy Specialist at the ISO, made a presentation on issues involved in creating an availability incentive mechanism for resources providing reliability services.³ These issues include definition of relevant metrics for availability and whether penalties for unavailability should reflect market conditions and bids.

In the last part of the MSC meeting, Dr. Harvey made a presentation⁴ summarizing how other ISO markets (ISO-New England, NYISO, PJM, and MISO) handle the issue of gas price volatility. He summarized how other markets provide flexibility in bidding start-up and minimum-load costs, and in adjusting energy offer prices between the day-ahead and real-time markets. He concluded by suggesting that three lessons have been learned from experience elsewhere: (1) that restrictions upon day-to-day changes in start-up and minimum-load costs can reduce availability of gas-fired generation and yield inefficient dispatch; (2) restrictions on changing incremental energy offer prices during the day can result in offers that fail to reflect gas supply conditions; and (3) mitigation of energy offers based on out-of-date gas prices can make it uneconomic for gas-fired generators to acquire gas, and can lead to uneconomic dispatch of gas-fired generation, potentially undermining gas system reliability.

¹ Available from www.caiso.com/Pages/documentsbygroup.aspx?GroupID=ECE0AA86-8517-4692-9ACC-20043A5EDF22

² S. Harvey, "Is the California ISO Becoming an Uplift Market? Pricing, Uplift and Commitment", www.caiso.com/Documents/BriefingISO_MarketPricing-MSCPresentation-May19_2014.pdf

³C. Bentley, "Availability Incentive Mechanism, MSC Meeting," www.caiso.com/Documents/ResourceAdequacyAvailabilityIncentiveMechanism-MSCPresentationMay2014.pdf

⁴S. Harvey, "Gas Prices and Offer Price Flexibility in Other ISO/RTO Markets," www.caiso.com/Documents/BriefingPotentialChangesCommitmentCostPricing-MSCPresentation-May19_2014.pdf

Opinion on Local Market Power Mitigation in the Energy Imbalance Market

The recommendation of both Management and the Department of Market Monitoring of the California ISO is to apply the ISO's existing LMPM framework with one additional, previously proposed, change. This change would allow LMPM to be applied when there is congestion over the EIM transmission transfer limits between EIM balancing authority areas, in addition to the planned policy of applying it to uncompetitive transmission constraints that are internal to the EIM balancing authority areas.

We have discussed several aspects of the EIM design, including market power mitigation, in detail in our October 2013 opinion on this topic.⁵ In addition, market power mitigation in the EIM has been addressed at several MSC meetings over 2013 and 2014.⁶ Our previous opinion expressed strong support for the creation of the EIM. However, in contrast to the market structure within the ISO, the supply and demand for energy in the areas that will begin participating in the EIM in October 2014 will be dominated by the vertically-integrated assets of PacifiCorp. There will remain in these areas a need for balancing services to accommodate the varying supplies of non-utility (particularly intermittent) generation as well as a relatively small amount of non-PacifiCorp load. With the adoption of the EIM, the pricing of imbalance energy will transition from an administrated rate overseen and approved by FERC to market-based pricing determined by the EIM dispatch. This transition would not be appropriate if the market-based balancing price were materially impacted by the exercise of market-power.

In this opinion, which is scheduled to be discussed and adopted during an MSC general session teleconference meeting on July 7, 2014, we will summarize the ISO proposal for modifying the LMPM framework and provide our assessment of it.

⁵ See Bushnell, Harvey, Hobbs, and Oren, "Opinion on Initial Implementation of the Energy Imbalance Market and Related Market Design Changes." Market Surveillance Committee of the CAISO, October 28, 2013, www.caiso.com/Documents/FinalOpinion_EnergyImbalanceMarketOct30_2013.pdf

⁶ The EIM and, in particular, the application of LMPM to EIM have been discussed in MSC meetings in Folsom on July 2 and September 6, 2013, and March 11 and May 19, 2014. In addition, MSC members have participated in a number of stakeholder calls discussing the EIM design and implementation.