



**GENERAL SESSION MINUTES
MARKET SURVEILLANCE COMMITTEE MEETING
June 6, 2011, 2:00 PM
General Session Teleconference Meeting
Offices of the ISO,
250 Outcropping Way
Folsom, CA 95630**

A meeting of the Market Surveillance Committee (MSC) was held at the time and place referenced above, pursuant to the Public Notice (final released June 2, 2011), posted on the CAISO Web site at <http://www.caiso.com/23c2/23c2c4412f6c0.html>. This meeting was also a joint CAISO stakeholder meeting on topics contained in the Public Notice.

ATTENDANCE

The following members of the MSC were in attendance:

James Bushnell, via teleconference
Benjamin Hobbs, via teleconference
Steven Stoff, via teleconference
Scott Harvey, via teleconference

The following ISO staff members were present: Jeff McDonald, John Goodin, Eric Little, Brad Cooper, and (via telephone) David Zlotlow. Other members of the public joined in on the conference call; those parties are listed on a conference participant list compiled by the telephone service provider.

GENERAL SESSION

The following agenda items were discussed in general session:

ELECTION OF MARKET SURVEILLANCE COMMITTEE CHAIR

Motion

Committee member Bushnell:

Moved, that the Market Surveillance Committee, Advisory Committee to the Board of Governors of the California Independent System Operator Corporation, elects Benjamin Hobbs to serve as Chair of the Market Surveillance Committee,

subject to confirmation by the Board, pursuant to section II(c) of the Market Surveillance Committee Charter.

The motion was seconded by Committee member Stoft, and approved 4-0-0.

DRAFT OPINION ON SUPPLEMENTAL OPINION ON ECONOMIC ISSUES RAISED BY FERC ORDER 745.

Discussion

Dr. Benjamin Hobbs provided the public with a summary of the supplemental opinion and noted that Dr. Steven Stoft would also be summarizing his concurring opinion. Dr. Hobbs noted that on April 29 the MSC adopted the opinion supporting the ISO's request for a rehearing of FERC order 745. In this supplemental opinion the MSC wanted to provide a full analysis of some of the core economic problems with the design of the order and define the results of the implementation. According to Dr. Hobbs, the MSC would like demand response to succeed but the long run goal of full participation by demand would be negatively affected by public reaction to the outcome of this order if implemented in its present form.

The opinion contains four substantive sections. Section two demonstrates that the effect of FERC order 745 is actually to discriminate in favor of certain types of demand response by instituting a market design that will pay such demand response well in excess of LMP. The discrimination is especially pronounced in relative terms during periods of moderate and low prices in the market. The MSC views this discrimination as arbitrary based simply on the location of the resource on one side or the other of the customer's meter.

In sections three and four, the MSC looked at the implications of this discrimination, arguing that the result is likely to be inefficient deployment of demand response (including distributed generation) and a risk of increased phantom demand response.

In section five, the MSC examined the Commission's proposed Net Benefits Test. They argue that the Net Benefits Test is not a test of market benefits but instead benefits one set of market parties, which they believe is an inappropriate philosophy for a market test. The MSC also believes that the test will fail to correctly represent both short run and long run benefits to consumers. As a result of paying more than LMP to inefficient demand response resources, the result will ultimately yield increased, not decreased, costs to consumers.

In the last section, the MSC summarized and concluded their views and stated that subsidizing demand response in bulk power markets, in this manner, will actually increase obstacles to retail demand response.

Next Dr. Stoft was given an opportunity to summarize his concurring opinion titled "*Opinion on Economic Issues Raised by FERC Order 745, 'Demand Response Compensation in Organized Wholesale Energy Markets.'*" Dr. Stoft began by noting that his opinion speaks directly to the inevitable legal appeal of Order 745. Because of legal precedent concerning the separation of powers between the branches of the government, the appeals court should and probably will ignore the technical arguments

in FERC's area of expertise. Stoft points out that only the most fundamental economic points will be relevant. This explains his discussion of FERC's reliance of what it calls "The Capability to Balance the Market." Dr. Stoft pointed out that PJM is concerned that demand response will be ruled outside of FERC's jurisdiction. However, the capability to balance argument was created to prevent that legal problem - by arguing that the LMP payment is purely for services that have nothing to do with the retail market. Dr. Stoft went on to say that the LMP payment is purely for wholesale balancing and for reducing wholesale market power. Legally this is a good defense for paying the LMP but the economic error entailed in this argument is so fundamental that it could play a significant role in the appeal. Stoft also argues that according to FERC's explanation of the net benefits test, the test itself confirms that the order will cause the exercise of monopsony power.

The final point of interest noted by Dr. Stoft is the mistake in FERC's formula for the cost component for the nets benefits test. The cost is the Retail Rate x Amount of Demand Response and not the LMP x Demand Response. Correcting this error would raise the threshold price for paying the LMP and would open the door to using the retail rate in other Order 745 calculations.

Next, Chairman Hobbs asked if the other committee members had anything else they would like to add to the discussion. Dr. James Bushnell, MSC member, added that the MSC has supported and highlighted the need for true demand response in the past. The concern here is that this isn't a second best or "good enough" approach; rather, to the extent that the market consolidates around this form of demand response and these kinds of market mechanisms, it could provide an excuse for local regulatory jurisdictions to avoid adopting valuable demand response tools such as critical peak pricing and real-time pricing. The latter retail mechanisms would be much more likely to give valuable demand response than the type of bulk demand response considered in the FERC Order, but there is a real concern that the latter type of demand response would crowd out retail solutions especially if participants in the market find bulk demand response to be more lucrative for the wrong reasons. Therefore, once bulk demand response of the type promoted by this Order is established, it may be very hard to replace with something the MSC feels is better.

Having nothing further, Chairman Hobbs opened the call up for any stakeholder comments.

Mr. Ian Quirk, on behalf of PG&E, pointed out that the dial-in number on the ISO's Master Calendar was incorrect and that the correct number could be found on the meeting agenda. Apologizing for the error, Chairman Hobbs thanked Mr. Quirk for bringing this error to the attention of the MSC. Moving onto the next comment, Elizabeth Dorman of the CPUC's legal division thanked the MSC for their efforts and thorough analysis of this order.

Receiving no further comment, Chairman Hobbs asked the comment for the adoption of the opinion.

Motion

Committee member Bushnell:

Moved that the Market Surveillance Committee, an Advisory Committee to the Board of Governors of the California Independent System Operator Corporation, adopts the draft opinion titled “Supplemental Opinion on Economic Issues Raised by FERC Order 745, Demand Response Compensation in Organized Wholesale Energy Markets”, as final; and

Moved that the Market Surveillance Committee acknowledges the concurring opinion on “Economic Issues Raised by FERC Order 745, Demand Response Compensation in Organized Wholesale Energy Markets”, by Steven Stoff, member of the Market Surveillance Committee.

The motion was seconded by Committee member Harvey, and approved 4-0-0.

ADJOURNED

There being no additional general session items to discuss, the general session of the MSC was adjourned at approximately 2:30.

The MSC has approved these Minutes of the June 6, 2011, MSC Meeting at the following MSC Meeting:

Date of approval: July 1, 2011