



**CALIFORNIA ISO**

# **Quarterly Report on Use of Condition 2 RMR Units Outside of The RMR Contract**

July – September 2004

Prepared by the Department of Market Analysis  
California Independent System Operator  
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## Background

In Amendment No. 60, the CAISO proposed to modify the ISO Tariff to establish a framework for calling on Condition 2 Reliability Must-Run (“RMR”) Units out-of-market (“OOM”) to meet various system reliability requirements that may arise (as opposed to local reliability requirements used in the RMR designation process)<sup>1</sup>.

In its July 8, 2004 order on Amendment No. 60,<sup>2</sup> the Federal Regulatory Energy Commission (“Commission”) directed the ISO to modify its proposal concerning the dispatch of Condition 2 RMR Units to reflect that such units may only be dispatched out-of-market (“OOM”) when a System Emergency is imminent or threatened and the ISO has issued an appropriate notice to Market Participants of this threat to grid reliability. The Commission also directed the ISO to stipulate in its compliance filing what constitutes reasonable efforts to use all available and effective non-Condition 2 RMR Units before issuing an OOM dispatch to Condition 2 RMR Units. Pursuant to the Commission’s July 8 Order, the ISO also modified its Tariff so that if an Condition 2 RMR Unit is dispatched out-of-market under this authority, the owner is paid a premium rate, which includes its variable costs plus a premium based on Schedule G of the RMR Contract.

The Amendment No. 60 Order also required that the ISO’s Department of Market Analysis (“DMA”) monitor the dispatch of Condition 2 RMR Units for system reliability, and to report this information to the Commission on a quarterly basis. In its August 10, 2004 Compliance filing, the ISO indicated that the ISO would provide its first quarterly report by November 1, 2002 for the quarter ended September 30, 2004.<sup>3</sup>

In addition, the Amendment No. 60 Order indicated that:

We have concerns regarding the market prices that result from out-of-market dispatch of Condition 2 Units, especially during system emergencies. Out-of-market purchases may artificially dampen the appropriate real-time clearing price. It is possible that the incremental cost of dispatching of Condition 2 Units may be higher than any accepted market bid in the BEEP stack. In this case, the real-time price will not reflect the actual incremental cost of serving CAISO load. It is appropriate that the price reflect the cost of the least efficient unit dispatched to serve load. The use of out-of-market purchases can also create a potential

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<sup>1</sup> See Amendment No. 60 Transmittal Letter, pp. 36-42.

<sup>2</sup> *California Independent System Operator Corporation*, 108 FERC ¶ 61,022 (2004) (“Amendment No. 60 Order”).

<sup>3</sup> August 10, 2004 Compliance Filing Transmittal Letter at 2.

opportunity for monopsony abuse. Accordingly, we direct the DMA to evaluate the merits of setting the real-time market clearing price, during system emergencies, at the higher of (1) the incremental costs of the Condition 2 Unit used to serve system load and (2) the highest accepted market bid.

Amendment No. 60 Order at P 51. The following report is provided in response to the above directives in the Amendment No. 60 Order.

### **Out-of-Market Dispatches of Condition 2 Units**

Since Amendment No. 60 was filed in May 2004, the ISO has dispatched a Condition 2 RMR Unit out-of-market on only one occasion. This occurred on July 6, when one Condition 2 RMR Unit was instructed to run out-of-market at its minimum operating level between hours 13 to 24. The reason for the dispatch was a transmission outage of the California-Oregon Intertie, which required additional on-line generation in Northern California to ensure system reliability. The Condition 2 RMR Unit generated energy at its minimum operating level during these hours, and was not dispatched to provide any additional system energy during that period.

Since this OOM dispatch occurred on July 6, two days prior to the Commission's July 8, 2004 Amendment No. 60 Order, requirements relating to notification of market participants subsequently established by the Amendment No. 60 Order were not in effect at the time of this OOM dispatch, and the ISO did not issue a market notice regarding the commitment of Condition 2 RMR capacity for system reliability.

### **Should RMR Condition 2 Units Be Allowed To Set the MCP?**

DMA agrees that during system emergencies, it would be economically efficient and equitable to allow the real time market clearing price ("MCP") to be set at the higher of (1) the incremental cost of the Condition 2 RMR Unit dispatched for energy needed to serve overall system (or zonal) load, and (2) the highest accepted market bid. However, DMA believes that Condition 2 RMR Units called out-of-market should be eligible to set the market clearing price only when they are marginal, which occurs only when such units are dispatched above their minimum operating levels (or "dispatchable minimum operating level") for additional energy needed to meet system (or zonal) load.

In practice, due to the start-up times associated with thermal units, the ISO may need to issue an OOM dispatch in order to start up an RMR Condition 2 unit well in advance of the time that critical system conditions may be anticipated possible. In such cases, however, the ISO will typically issue an OOM dispatch for the unit to operate only at its minimum operating level. If the unit is then actually needed to meet system (or zonal) demand for imbalance energy, an

additional OOM dispatch will be issued during or just prior to the operating hour. In such cases, the RMR Condition 2 unit can only be considered the “marginal unit” (which should be eligible to set the market-wide MCP) if it is dispatched above its minimum load to meet system load. Thus, in the July 6, 2004 case described above, the Condition 2 unit should not be eligible to set the MCP since it was not dispatched in real time for additional energy to meet system load. This reflects the principle that the market-wide MCP for imbalance Energy should reflect the incremental marginal cost of the marginal unit dispatched to meet demand in real time.

In addition, it should be noted that Condition 2 RMR units – like any other unit --- should not be eligible to set system or zonal MCPs in cases when units were dispatched for intra-zonal or other locational constraints (as opposed to zonal or system-wide imbalance energy needs). This is consistent with manner in which other real time energy dispatches for intra-zonal congestion are treated, as well as how the Must-Offer process works. For example, units having Must-Offer waiver requests denied are required in advance to run at minimum operating levels, and bid all remaining capacity into the real time energy market. The bids to provide Energy above the minimum operating level -- like all other real time energy bids -- are allowed to set the MCP if they are subsequently dispatched for system or zonal Energy needs through the real-time market, but are not allowed to set the price when dispatched due to intra-zonal or other locational constraints. This again reflects the principle that the market wide MCP for imbalance Energy should reflect the incremental marginal cost of the marginal unit dispatched to meet demand in real time.

As a practical matter, DMA believes that when Condition 2 RMR units are dispatched above minimum operating levels to provide additional system energy or zonal energy (rather than simply for on-line capacity that may be needed to meet demand), MCPs will typically exceed or be comparable to the incremental costs of these units.

## Conclusion

If Condition 2 RMR Units are allowed to set the MCP, DMA recommends that Condition 2 RMR Units should be allowed to set the MCP only when those units are dispatched above their minimum operating levels.

DMA will continue to monitor the dispatch of Condition 2 RMR Units for system reliability, and provide similar data and analysis on any such dispatches on a quarterly basis.