CALIFORNIA ISO

WPTF Comments on 2004 Annual Market Issues and Performance Report

Market Surveillance Committee Meeting

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- The wholesale markets were neither healthy nor stable in 2004; Long-term markets have not spurred generation capacity additions in southern California
  - ➢ Purpose of Report was to evaluate short-term energy markets during 2004
- Supply Demand Balance Deteriorating--Reserve Margins are declining and there are no new power plant investments to meet California's load growth in 2006 and beyond
  - ➢ Although reserve margins did decline between 2003 and 2004, they did not decline to a point that made the short-term energy markets uncompetitive or create shortage conditions in 2004
- Insufficient revenues to cover the costs of new investment; Market operating at a sub-competitive level and immediate reforms are needed to attract new investment.
  - ➢ Level of forward contracting allowed short-term energy market pricing to be highly competitive; Existing resources that signed long-term contracts with State or utility unlikely to be revenue deficient; Potential upcoming capacity shortage would not have affected 2004 short-term energy prices; Leaving investment signals up to spot markets eventually leads to serious market dysfunction.

WPTF Comments on 2004 Annual Market Issues and Performance Report (Continued)

- A $5 to $10/MWh Markup in not a reasonable measure of competitive market performance; WPTF recommends using a long-run marginal cost based benchmark.
  - With perfect information under effectively competitive spot market conditions, short run system marginal cost should approximate actual market prices.
  - Inappropriate to use a long-run marginal cost based benchmark to measure the performance of the short-term energy market. Would expect annual average prices in a workably competitive market to recover average cost of new generation over the life of the asset considering both spot and bilateral sales.
- Ancillary services market bid insufficiency is a symptom of a market that provides inadequate incentives for RMR units to stay under condition 1 RMR contract
  - Shift from condition 1 to condition 2 large cause of current bid insufficiency problem, other factors include shift to locational procurement. Contractual restrictions often keep RMR condition 2 out of ancillary service markets. Market and contract modifications should be considered to make condition 2 capacity available to ancillary services markets.