

Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel and Corporate Secretary

Date: September 2, 2009

Re: **Decision on Ancillary Services Procurement in the Hour-Ahead Scheduling Process**

This memorandum requires Board action.

EXECUTIVE SUMMARY

Prior to the start of the new market, the California Independent System Operator Corporation (ISO) deferred implementation of market functionality that would have enabled the ISO to procure ancillary services from resources located outside of the ISO balancing authority area that lack telemetry with the ISO's energy management system (non-dynamic system resources) in the hour-ahead scheduling process (HASP). Consequently, as far as external resources are concerned, the ISO has been procuring ancillary services from both dynamic (external resources with telemetry) and non-dynamic system resources in the day-ahead market but only dynamic system resources in real-time market. The ISO deferred this functionality because the original software design could not accommodate the dispatch constraints of non-dynamic system resources' ancillary services in the real-time market.

In order to allow procurement of ancillary services from non-dynamic system resources in HASP, Management requests that the ISO Board of Governors (Board) approve the approach described below for dispatching energy from non dynamic system resources in the real time market. Specifically, Management proposes to dispatch energy from non-dynamic system resources at a constant level through the end of any given hour rather than on a five minute basis.

Management also requests that the Board approve that energy bids associated with un-awarded HASP ancillary service bids will not be considered for dispatch in the real-time market. Management developed this proposal in response to its commitment to consider the reinstatement of deferred functionality and in response to stakeholders concerns regarding this functionality.

Moved, that the ISO Board of Governors approves the market rule changes necessary to allow procurement of ancillary services in hour ahead scheduling process from non-dynamic system resources as described in the memorandum dated September 2, 2009; and

Moved, that the ISO Board of Governors authorizes Management to make all the necessary and appropriate tariff filings with the Federal Energy Regulatory Commission to implement these policies.

BACKGROUND AND DISCUSSION

Dispatch of Energy from Ancillary Services Procured from Non-Dynamic System Resources in HASP

Within any given hour, the ISO has limited flexibility to dispatch energy from ancillary services for non-dynamic system resources procured in the previous hour. This is largely due to agreements between importers and neighboring Balancing Authority Areas that typically allow external resources to make only one mid-hour schedule change. Under the previous design, in order for ancillary services from external resources capacity procured in HASP to be effective during the real-time hour, the ISO had to be able to dispatch energy from such reserves in real-time on a five-minute basis. Because of this design limitation, the ISO requested approval from the Federal Energy Regulatory Commission (FERC) to defer the HASP ancillary services procurement functionality. FERC approved the deferral of this functionality on January 30, 2009,¹ and the ISO commenced its new market operations on April 1, 2009, without the ability to procure ancillary services from non-dynamic system resources in HASP.

In recent months, Management discussed with stakeholders a proposed solution that changes the dispatch logic for energy from ancillary services procured from non-dynamic system resources in HASP. Under the proposed solution, if a non-dynamic system resource receives a dispatch instruction in mid-hour for energy associated with its ancillary services (operating reserve) capacity awarded in HASP, the ISO will dispatch the resource to operate at a constant level until the end of the hour. In the event that the ISO dispatches the system resource across an hourly boundary, the energy will be dispatched at a constant level until the end of the next hour.

Management proposes to adopt these new dispatch rules so that it can procure ancillary services from non-dynamic system resources in HASP and use the associated energy as needed to manage contingency situations in the real-time. The proposed dispatch rules are widely supported by stakeholders.

Treatment of Energy Bids Associated with Ancillary Services Bids from Non-Dynamic System Resources

Under the current market rules, when a scheduling coordinator submits an ancillary services bid in the HASP or real-time market it is required to also submit an associated energy bid. In addition, even if the ISO does not award the ancillary service bid in HASP, it may still dispatch the associated energy bid in the real-time five-minute energy market. While discussing the merits of the proposed energy

¹ *California Independent System Corp.*, 126 FERC ¶ 61,081 (2009).

dispatch rules discussed above in the recent stakeholder process, stakeholders expressed concerns that the tariff language should be clarified so as to exempt non-dynamic system resources from these otherwise generally applicable rules. See Attachment A for the stakeholder matrix.

Management proposes the following rule changes regarding the treatment of energy bids submitted together with ancillary services bids in HASP by non-dynamic system resources to address stakeholder concerns:

- Non-dynamic system resources would continue to be required to submit an energy bid associated with an ancillary services bid in HASP or the real-time market. However, only ancillary service bids will be used to solve the optimization problem and the associated energy bids will not be used. In this case, the resulting ancillary service prices will reflect the cost of providing capacity but not the opportunity cost of providing energy.
- In the event that these ancillary service bids are awarded in HASP, they will be available for contingency dispatch in real-time.

These rule changes would prevent the dispatch of energy bids associated with ancillary services bids in the event that the ISO does not award the ancillary services bid in the HASP. Stakeholders did not express any opposition to these proposed rule changes.

MANAGEMENT RECOMMENDATION

Management recommends the Board approve the policy to allow the ISO to procure ancillary services from non-dynamic system resources in HASP and the related modifications concerning how energy bids from such resources are treated in the real-time market.