

# Memorandum

**To:** ISO Board of Governors

**From:** Frank A. Wolak, Chairman, ISO Market Surveillance Committee

**Date:** July 16, 2010

**Re:** *MSC Activities from April 28, 2010 to July 16, 2010*

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*This memorandum does not require Board action.*

The Market Surveillance Committee (MSC) has been involved in four major activities over the past two months: (1) completing a review of the performance of ISO's local market power mitigation mechanism under the new market design, (2) preparing an opinion on the ISO's commitment costs proposal, (3) holding a meeting on June 4, 2010, and (4) participating in the formulation of revisions to the ISO's policy on dynamic transfers. MSC members have also participated in numerous phone calls and conference calls with stakeholders on a variety of ISO market-related issues.

## ***Report on ISO's Local Market Power Mitigation Mechanism***

The MSC was asked by the Federal Energy Regulatory Commission to evaluate the ISO's current methodology for mitigating local market power under the new market design. To that end, the MSC prepared a report on the operation of ISO's market power mitigation mechanism and market power mitigation mechanisms in other ISOs in the United States and around the world. The resulting document, "Report on the Performance of the California ISO's Local Market Power Mitigation Mechanism during the First Year," was discussed with stakeholders and ISO staff at the June 4, 2010, MSC meeting and subsequently adopted by the MSC and submitted to the FERC.

The report concluded that the unique circumstances in the California economy and electricity supply industry over the past year make it imprudent to draw any conclusions about the properties of the California ISO's LMPM mechanism from these market outcomes. The report then assessed the major concern of generation unit owners with the existing LMPM mechanism that a small number of transmission paths have been designated as competitive and this designation is based on a prospective analysis based a set of pre-specified system conditions, rather than actual system conditions. For this reason, the report recommended that the ISO investigate alternatives to the current LMPM mechanism that rely on the most up-to-date information on the ability of a generation unit owner to exercise unilateral market power, so as to mitigate the supplier only when the generation unit owner has a significant ability and incentive

to exercise local market power. To this end the report suggested that the ISO investigate the properties of a residual demand curve based-approach versus the current LMPM mechanism. The report laid out the general properties of this approach and discussed potential advantages of and implementation challenges associated with incorporating it into the ISO's LMPM mechanism. The report expressed the MSC's willingness to work with the ISO's Department of Market Monitoring on this comparative analysis research effort.

### ***Opinion on the ISO's Commitments Costs Proposal***

The MSC members provided feedback to ISO staff and stakeholders on refinements to the ISO's start-up and minimum load costs proposal throughout the stakeholder process. The MSC prepared an opinion on the final proposal entitled, "Opinion on Changes to Bidding and Mitigation of Commitment Costs," which was discussed at the June 4, 2010, MSC meeting and subsequently adopted by the MSC.

The opinion expressed support for most of the recommended changes, including the ISO's recommendation not to consider opportunity cost in determining the level of mitigated start-up and minimum load offers. The MSC also agreed with the ISO's recommendation to retain a 30-day minimum time period between changes in registered costs for start-up, minimum load and transition costs for multistage generators (MSGs) because of concerns about the possibility that market participants could use this flexibility to raise short-term market prices in response to temporary market conditions that increase their ability to exercise unilateral market power. The opinion suggested a change to the MSG transition costs mitigation procedure in order to allow bid-in transition costs to be decreased in an analogous manner to how the ISO's proposal allowed start-up and minimum load cost offers to be decreased. This would make the treatment of multistage generator transition costs consistent with the proxy cost option for simple generators' start-up costs.

### ***June 4, 2010, MSC Meeting***

The MSC held an all-day meeting at the ISO on June 4, 2010. The morning was devoted to discussing and approving the MSC's report on the performance of the ISO's local market power mitigation mechanism during the first year of operation of the new market and its opinion on the ISO's generation unit commitment costs proposal. The afternoon was devoted to topics related to the ISO's local market power mitigation mechanism. The first topic was concerned with modifications to incorporate bid-in demand to the ISO's local market power mitigation procedures. The ISO's current proposal was reviewed and compared to alternatives proposed by stakeholders and the MSC. The final topic was the possible revision of the ISO's local market power mitigation mechanism to incorporate a residual demand curve-based approach. The consideration of this approach and comparison with the ISO's existing LMPM mechanism was recommended by the MSC in its review of the ISO's market power mitigation mechanism.

### ***Revisions to ISO's Dynamic Transfer Procedure***

The increasing number of renewable generation projects constructed or proposed for construction outside of the California ISO control area intending to sell energy to customers served by retailers inside the California ISO control area has necessitated reconsideration of the ISO's procedures for dynamic scheduling. The major challenge faced by the ISO is how to allocate and pay for the costs of dealing with the intermittency of these renewable energy

resources. A number of proposals are currently under consideration that range from allocating all of these costs to the renewable resource or its control area to allocating all of the costs to consumers in the ISO control area. There are also a number of intermediate proposals under discussion. MSC members have participated in several meetings and phone calls with ISO staff to discuss these proposals and a stakeholder conference call on June 18, 2010. The MSC will continue to work with ISO staff on this issue and currently plans to issue an opinion on the ISO's proposal in August.

***Additional Stakeholder Interactions***

MSC members have also participated in phone calls and conference calls on a number of past, current, and future issues related to the ISO markets over the past month. The vast majority of these interactions are initiated by stakeholders. Topics discussed include commitment costs, demand response mechanisms, convergence bidding, and dynamic scheduling.