



Memorandum

To: ISO Board of Governors

From: Keith Casey, Vice President, Market & Infrastructure Development

Date: July 5, 2012

Re: **Decision on Modifying Rules for Rescission of Ancillary Service Capacity Payment**

This memorandum requires Board action.

EXECUTIVE SUMMARY

Management proposes to modify the settlement treatment of ancillary service capacity awarded in the day-ahead market that is later deemed unavailable prior to the real-time market. After the close of the day-ahead market, the ISO analyzes ancillary service awards to ensure that resources are able to provide the service in real-time given changes in system conditions or resource operating limitations. In the event that a day-ahead ancillary service award is determined to be unavailable prior to the real-time pre-dispatch process, the ISO procures additional ancillary services to meet reserve requirements.

Currently, resources still receive a capacity payment when the day-ahead awarded ancillary service capacity is determined to be unavailable prior to the real-time pre-dispatch process. Management proposes to rescind payments for ancillary service capacity awarded in the day-ahead market that is later determined to be unavailable prior to the real-time pre-dispatch process due to changes in a resource's operating limitations. However, if a resource's capacity becomes unavailable due to an internal transmission outage or other change in system conditions that are outside of a resource's control, the resource will continue to receive its day-ahead ancillary service capacity payment.

Management proposes the following motion:

Moved, that the ISO Board of Governors approves the proposed tariff change regarding modifying the rules for recession of ancillary service capacity payment, as described in the memorandum dated July 5, 2012; and

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

DISCUSSION AND ANALYSIS

Since implementing the new wholesale market design in 2009, Management has worked to enhance the efficiency of the ISO's ancillary services markets, including the real-time ancillary service qualification method. Last year, the ISO introduced the use of dynamic ramp rates in ancillary services capacity procurement. This feature provides greater assurance that ancillary service capacity awarded to a resource in the day-ahead market will be deliverable in real-time. In connection with these efforts, Management identified a gap in how the ISO market systems settle ancillary service capacity awards that are subject to cancellation between the close of the day-ahead market and the real-time pre-dispatch process.

Ancillary service awards in the day-ahead market can be canceled when system conditions change due to generation or transmission outages that occur after the close of the day-ahead market, but before the real-time pre-dispatch process. These changes cause previously scheduled capacity to become unavailable. Awards can be canceled due to changes in a resource's physical operating limitations that occur after the day-ahead market award. Changes in a resource's physical operating limitation can be caused by a change in the ramp rate submitted by the resource or a de-rate of the resource's output capability. To maintain required reserve levels, in the real-time pre-dispatch process, the market optimization procures additional ancillary services to replace day-ahead ancillary service awards that were canceled.

Cancellation of ancillary service awards can be initiated manually by operators or through the ISO's automated market systems. Under the existing tariff, resources with ancillary service capacity awards determined to be unavailable after the real-time pre-dispatch process have their day-ahead capacity payments rescinded. The current ancillary service payment rescission rules, however, do not extend to ancillary service capacity that becomes unavailable between the day-ahead market and the real-time pre-dispatch process.

Management believes this inconsistent settlement treatment should be corrected and proposes to apply its payment rescission rules to ancillary service capacity awarded in the day-ahead market that later, before the real-time pre-dispatch, becomes unavailable as a result of a change in the resource's operating limitations. However, if a resource's capacity becomes unavailable due to a change in system conditions outside its control, such as an internal transmission outage, the resource will continue to receive its day-ahead capacity payment. This change in settlement rules will ensure that resources will be compensated only when the resource can provide ancillary services capacity to the market.

POSITIONS OF THE PARTIES

Stakeholders are generally supportive of the proposed market enhancements. The final proposal addresses concerns raised by stakeholders regarding rescission of payments when changes in system conditions are outside of their control. Management

addressed this concern by retaining the rule that allows resources to maintain their day-ahead payment for ancillary service capacity, if the capacity becomes unavailable due to internal transmission outages.

CONCLUSION

Management requests Board approval of the proposed modifications to the rules for rescission on ancillary service capacity payment as described in this memorandum. The modified rules will provide consistent settlement treatment for the rescission of ancillary service capacity awarded in both the day-ahead and real-time markets.