Memorandum

To: ISO Board of Governors

From: Benjamin F. Hobbs, Chair, ISO Market Surveillance Committee

Date: February 9, 2012

Re: **Briefing on MSC Activities from December 1, 2011 to January 31, 2012**

This memorandum does not require Board action.

Over the period covered by this memorandum, the Market Surveillance Committee held a public meeting on December 8, 2011 in Folsom in which a formal opinion was adopted on three issues in the renewable integration market & product review, phase 1. The MSC also held a public teleconference meeting on January 24, 2012. Besides the phase 1 issues, ISO initiatives and issues that were discussed in those meetings included: flexible ramping products; the regulation pay for performance initiative; the integration of transmission planning and generator interconnection initiative; and the post-emergency bid cost recovery review. In addition, individual members of the committee held phone discussions with staff and stakeholders and participated in ISO public calls and meetings on these initiatives.

1. Opinion on Renewable Integration Market & Product Review, Phase 1

The purpose of the initiatives under review is to ensure that ISO market products and procedures can accommodate increased penetration of renewable resources as the market moves towards the 2020 State of California target of 33%. In the December 8, 2011 MSC meeting, the committee adopted the final version of the November 18, 2011 draft MSC opinion on phase 1 proposals on participating intermittent resource program, minimum bids, and bid cost recovery.[1] MSC member Jim Bushnell then presented the adopted opinion at the December Board meeting.

The opinion was summarized in the previous (November 30, 2011) update on MSC activities.[2] In brief, the MSC strongly supported the goal of encouraging economic bids that would allow for downward generation adjustments in response to negative real-time prices. We also supported the general direction of the ISO's proposals as likely being effective in

[1] www.caiso.com/Documents/MSC_Final_Opinion_RenewableIntegrationMarket-ProductReviewPhase1.pdf

[2] www.caiso.com/Documents/MarketSurveillanceCommitteeUpdateDec2011.pdf

advancing that goal in the short-run, which is the focus of the phase 1 process. Specific suggestions were made regarding two aspects of the proposals. First, we recommended that a review be conducted of market performance under a -$150/MWh bid floor before proceeding to a -$300/MWh bid floor. Second, we recommended testing and, if appropriate, refinements of the proposed performance measure and persistent uninstructed energy check features of the bid cost recovery proposal to ensure that they would function as intended. The ISO adopted both of these recommendations in their final proposal to the Board.

2. Regulation Pay for Performance

The Federal Energy Regulatory Commission adopted Order 755 on October 20, 2011 to ensure that providers of frequency regulation receive just and reasonable and not unduly discriminatory or preferential rates. The final rule requires a two-part payment for regulation: (1) a payment for regulation capacity and (2) a payment for the performance of the resource in response to the regulation signal, as measured by its cumulative movement or so-called 'mileage'.

The California ISO, as well as other RTOs under FERC jurisdiction, are presently developing proposals for market rules that would comply with that order. We have discussed the initial and revised California ISO proposals[3] with ISO staff and stakeholders, and devoted a portion of the January 24 public call to the issue. During the call, the MSC discussed some of the challenges in developing a two-part payment for frequency regulation. One challenge is that mileage is not a separate product in the ISO day-ahead and real-time market optimizations, and so does not automatically generate a price for mileage performance. Furthermore, the actual mileage that different types of frequency resources will provide in a given real-time interval is difficult to predict, and depends on their characteristics, interactions, and system conditions. Finally, the actual mileage incurred by a resource when regulation resources are dispatched is not based on an economic objective or on mileage bids, but rather based on preserving rampability in the system. These three challenges introduce a degree of arbitrariness in defining prices for mileage.

The objective of any revision of bidding and settlement procedures that are responsive to the FERC order should be transparency, provision of incentives to bid in a manner consistent with costs, and provision of incentives to bid frequency regulation resources into the market and enhance their flexibility. In the public call, alternatives for defining prices were discussed, and the challenges in meeting these objectives were discussed. One issue identified is that the above three challenges open up a significant possibility that owners of regulation would benefit from bidding in way that does not reflect their costs,

[3] www.caiso.com/Documents/PayPerformanceRegulationRevisedStrawProposal.pdf

which would then pose a risk of inefficiencies from choosing the wrong resources to meet regulation needs, and inflating costs to consumers.

Discussions with ISO staff and stakeholders will continue in the coming weeks. The MSC anticipates issuing a formal opinion at the time a proposal is submitted to the Board.

3. Integration of Transmission Planning and Generator Interconnection

The ISO is considering how the two separate transmission planning processes that it oversees can be better integrated. The issues involved in their integration have been discussed by the MSC at the December 8, 2011 MSC meeting and the January 24, 2012 public call.

There are two basic issues concerning the planning process that have been discussed The first issue is the allocation of ratepayer financed transmission to a generation pocket among parties with proposed generation in the interconnection queue when the total requests exceed the capacity of the new transmission. The second issue is how costs for constructed interconnection capacity with excess capacity should be allocated to generators who subsequently request to use that capacity.

In the MSC's discussions, members highlighted that the planning process has several objectives. Some of these include: progress towards meeting the state's renewable goals; avoiding construction of unneeded transmission capacity at ratepayer expense; providing information on interconnection costs to generators requesting interconnection; ensuring that the economically most preferable projects remain in the queue and are interconnected (where 'best' could be interpreted as a balance of generation and transmission costs, contribution to renewable targets, and value of the power provided); and providing incentives for nonviable projects to quickly leave the interconnection queue.

The MSC intends to issue a formal opinion when a proposal is to be submitted to the Board.

4. Flexible Ramping Product

The MSC continues to monitor development of this issue, which is currently being addressed in phase 2 of the renewable integration market & product review. Members have engaged in informal discussions with staff and stakeholders on the definition and pricing of the product, and its relationship to the other products in the ISO market. The MSC plans on issuing a formal opinion at an appropriate time.

5. Post-Emergency Bid Cost Recovery Review

ISO staff briefed the MSC on this issue during the December 8, 2011 MSC meeting. The issue concerns two emergency filings made earlier in 2011. The following questions to be addressed in the forthcoming stakeholder review were discussed during the meeting:

(1) Were the bid cost recovery rule changes effective in preventing the behavior of concern?
(2) Were there unintended consequences?
(3) Are there other problems with market behavior that resulted in an increase to bid cost recovery uplift payments?