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December 4, 1998

The Honorable David P. Boergers  
Acting Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

**Re: California Independent System Operator Corporation,  
Docket No. ER98- 3594-000  
Amendment to the ISO Tariff, Relating to Firm Transmission  
Rights**

Dear Secretary Boergers:

Pursuant to Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d, the California Independent System Operator Corporation ("ISO")<sup>1</sup> respectfully submits for filing six copies of an amendment to its June 30, 1998 filing in this docket, in which the ISO tendered Amendment No. 9 to the ISO Tariff.

## **Introduction and Background**

Amendment No. 9 proposed the addition of a new Article 9 to the ISO Tariff, governing the issuance and use of Firm Transmission Rights ("FTRs"), in compliance with the Commission's direction in earlier orders.<sup>2</sup> In submitting Amendment No. 9, the ISO explained that time did not permit completion of the development of one aspect of the FTR amendment : the detailed description of the auction process by which FTRs would be made available. As filed on June 30,

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<sup>1</sup> Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, ISO Tariff Appendix A, as filed August 15, 1997.

<sup>2</sup> *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,486 (1997) (the "October 30 Order"); *Pacific Gas & Electric Co., et al.*, 80 FERC ¶ 61,128 at 61,427 (1997) (the "July 30 Order").

Amendment No. 9 accordingly included only a general description of the auction process as proposed Section 9.4. In addition, on September 29, 1998, the ISO filed a motion for an extension of time for the implementation of FTRs.

The ISO is today tendering a revised version of Amendment No. 9 as an amendment to its June 30 filing. The revised Amendment No. 9 incorporates an expanded Section 9.4, providing a detailed description of the auction process for FTRs, which was developed with the assistance of consultants retained by the ISO for that purpose. The revised Amendment No. 9 also incorporates a number of other changes in response to comments received on the initial filing. These changes are discussed below. The ISO has also taken this opportunity to modify the format and page numbering of Amendment No. 9 to conform to the remainder of the ISO Tariff.

In addition, as explained below, the ISO requests guidance from the Commission on three questions associated with the operation of secondary markets for FTRs.

In order for the ISO to complete the initial auction of FTRs by March 30, 1999, the ISO must commence the auction process by February 1999. The ISO accordingly requests that the Commission consider Amendment No. 9, as revised, and issue a ruling by no later than January 29, 1999, permitting the amendment to take effect on February 3, 1999.

The ISO submits the following information in support of the revised Amendment No. 9:

- This transmittal letter;
- Revised tariff sheets reflecting Amendment No. 9, as revised (**Attachment A**);
- A black-lined version of Amendment No. 9, showing changes from the amendment, as filed on June 30, 1998 in this docket and, where applicable, to other sections of the ISO Tariff (**Attachment B**);
- The Opinion of the ISO's independent Market Surveillance Committee relating to monitoring and information disclosure requirements in secondary FTR markets (**Attachment C**);
- A draft description of the approach that the ISO expects to follow to increment prices between rounds of the auction, which, in accordance with the proposed tariff, will be posted on the ISO's Home Page before the auction commences (**Attachment D**); and

- A Notice suitable for publication in the Federal Register (in hard copy and diskette format) pursuant to 18 C.F.R. § 35.8 (**Attachment E**).

### **Service**

The ISO requests that all Commission orders and correspondence, as well as pleadings and correspondence from other persons concerning this filing, be served upon the individuals designated in the ISO's June 1, 1998 filing in this docket.

The ISO is serving copies of this filing on all parties on the official service list compiled by the Secretary in this docket, including the Public Utilities Commission of California and on the California Energy Commission, the California Electricity Oversight Board, and on all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff. In addition, the ISO is posting this transmittal letter and all attachments on the ISO's Home Page.

### **The FTR Auction Process**

As described in the revised Section 9.4, the ISO will conduct separate, simultaneous auctions for FTRs for each of the interface and direction combinations for which FTRs will be issued (52 markets in the initial auction). The auctions will proceed in multiple rounds to determine a market-clearing price for FTRs in each market. The general approach calls for the ISO to announce a price at which FTRs will be made available in each market, for bidders to submit bids for the quantities of FTRs they desire to purchase at those prices, and for the process to be repeated, at increasing prices, until the demand for FTRs matches the supply in each market. This approach is implemented in the following manner:

- Before the auction begins, the ISO will announce and post on its Home Page the quantity of FTRs being made available in each market, the schedule for the auction, and the prices at which FTRs will be made available in each market in the first round of the auction. The ISO will set those initial prices at levels expected to be low enough to induce the submission of bids in each market for more FTRs than are being made available, in accordance with the formula specified in Section 9.4.2.1(ii). The ISO will also announce and post the formula through which prices will be adjusted in subsequent rounds of the auction. Bidders will be required to pre-register to demonstrate that they satisfy financial qualifications.
- In each round of the auction, the ISO will announce a price at which FTRs will be made available in each market. Qualified bidders may then submit bids for the number of FTRs that they wish to acquire at that price. Between rounds of the auction, the ISO will advise all bidders of the total demand for FTRs in

each market, but not the demands of individual bidders. See Section 9.4.2.2. The auction will continue with subsequent rounds of bidding, with the price increased each time and bidders submitting bids for the number of FTRs they wish to acquire at the increased price (but not more than the number of FTRs for which they bid in the preceding round). If the demand for FTRs in a market is less than or equal to the number of FTRs being made available, the auction in that market will close. See Section 9.4.2.3.

- The market-clearing price in each market will be the price in the last round of the market at which demand for FTRs exceeded supply. See Section 9.4.2.4. Bidders in the final round of an auction will receive the number of FTRs for which they bid in that round, plus, for those bidders who requested a larger number of FTRs in the preceding round of the auction, which determines the market clearing price, a proportionate share of any excess FTRs. See Section 9.4.2.5. Bidders will have an opportunity to opt out of receiving a share of the excess FTRs, if they believe the value of a potentially small quantity of FTRs does not justify the costs of managing them.

The ISO believes the auction process described in revised Section 9.4 is fair and efficient. It will allow the separate determination of a market-clearing price for FTRs for each interface and direction combination and will allow the rights associated with FTRs to go to those entities that value them most highly. The proposed auction process implements the general concepts adopted by the stakeholders participating in the FTR working group and approved by the ISO's Governing Board.<sup>3</sup>

In addition, the auction process described in Section 9.4, in conjunction with the other provisions of Amendment No. 9, minimizes the opportunities for any entity to acquire FTRs for the purpose of exercising market power. As explained in the June 30 filing, the quantity of FTRs to be issued in each market is limited initially to one-fourth of the uncommitted capacity of the interface to reduce the prospect that FTRs could be hoarded. This prospect is further constrained by Section 9.4's procedures to conduct all auctions simultaneously, with disclosure of the total demand in each market, under rules that prohibit any bidder from increasing the number of FTRs for which it bids in any market. In addition, Section 9.8.2 of the ISO Tariff has been revised to require the ISO to publish on the ISO Home Page summaries of the concentration of ownership of FTRs in each FTR Market, which will enhance the ability of the ISO, its Market Surveillance Committee, and the Commission to determine whether FTRs are being hoarded.

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<sup>3</sup> These concepts are described in the Motion to Intervene of the Transmission Agency of Northern California at pages 26-27 (July 20, 1998).

### **Stakeholder Process and Other Tariff Changes**

The enclosed supplemental filing was developed through an extensive process in which all stakeholders were eligible to participate. Throughout September through November 1998, the ISO received input from stakeholders regarding auction design, the monitoring of secondary FTR markets, and related issues. The ISO also circulated drafts of tariff language, which were revised in response to stakeholder comments. The FTR proposal that is submitted today was approved by the ISO Board of Governors at its November 19, 1998 meeting. Stakeholders had an additional opportunity to submit comments on the proposed tariff language, which was considered by the Board's Market Issues/ADR Committee at a December 2, 1998 meeting.

In response to issues raised in the stakeholder process and in the interventions filed in response to the ISO's initial filing of Amendment No. 9, the revised filing also incorporates a number of changes other than those necessary to implement the auction design. Other principal changes are as follows:

- To conform to the structure of the ISO Tariff, definitions have been removed from Section 9.2 and other provisions and restated as additions to Appendix A, the Master Definitions Supplement. Other clarifying changes are made in Sections 9.1, 9.2, 9.3, 9.6.1, 9.7.2 and 9.8.1.
- To avoid confusion, a duplicative description of the manner in which Congestion-related Usage Charge revenues will be distributed to FTR Holders has been removed from Section 9.2.2 and replaced with a cross-reference to Section 9.6 in Section 9.2.1.
- The interaction between the rights of FTR Holders to Usage Charge revenues and the rights of Scheduling Coordinators and Participating Transmission Owners has been clarified by a reference in Section 9.2.1 to the rights of counter-scheduling Scheduling Coordinators, a reference in Section 9.5.1 to the distribution of FTR auction proceeds in proportion to the distribution of Usage Charges to Participating TOs in accordance with Section 7.3.1.6, and a reference in Section 7.3.1.6 to the rights of FTR Holders.
- To address the concerns of some stakeholders, the ISO Governing Board's determination initially to issue FTRs for twenty-five percent of the available capacity has been made explicit in Section 9.2.2.
- Section 9.2.6 now reflects a relationship between FTR Bidders' financial qualifications and the value of FTRs they may acquire, as well as the requirement that bidders have the technical equipment necessary to participate in the electronic auction.

- Section 9.3 now more clearly preserves the portion of interface capacity used to schedule transmission rights under Existing Contracts.
- The distribution of Usage Charge revenues from the Day Ahead and Hour Ahead Markets to FTR Holders has been clarified in Section 9.6.
- Section 9.8 has been revised to require notification to the ISO of transfers of FTRs in secondary markets and for the ISO to publish information on the ISO Home Page concerning the concentration of ownership of FTRs in each FTR Market. The opinion of the ISO's independent Market Surveillance Committee on this subject is included in this filing.

The ISO notes that the proposed Section 9 of the ISO Tariff, as revised by this supplemental filing, would create FTRs in connection with the transmission facilities over which the ISO has assumed operational control pursuant to the Transmission Control Agreement among the ISO and Transmission Owners dated February 6, 1998 (the "TCA"). Under the TCA, the ISO assumed operational control over those facilities subject to certain Encumbrances set forth in Appendix B to the TCA. FTRs would be implemented in a manner consistent with such Encumbrances. For example, in order to preserve the tax-exempt status of interest on "local furnishing" bonds issued for the benefit of San Diego Gas & Electric Company ("SDG&E"), Paragraph I(D) of the SDG&E Appendix B to the TCA generally provides that the ISO will not operate SDG&E's facilities "so as to curtail delivery of electric energy to [SDG&E's] native load customers involuntarily in order to provide electric energy to customers outside of [SDG&E's] electric service territory in San Diego and Orange Counties, unless such curtailment is necessitated by the failure of facilities either partially or wholly owned by SDG&E.

### **Request for Guidance Regarding Secondary Market Transactions**

In directing the ISO to develop a proposal for firm transmission rights, the Commission required that these rights be freely transferable.<sup>4</sup> Amendment No. 9 complies with this requirement, specifying that FTRs will be freely transferable in secondary markets. Discussions among stakeholders in California have identified three issues as to which Commission guidance is necessary for the development of secondary markets for FTRs.

First, the Commission should address whether the price caps applicable to the reassignment of point-to-point transmission rights obtained under an Order No.

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<sup>4</sup> June 30 Order, 80 FERC at 61,427.

888 pro forma tariff<sup>5</sup> would apply in the case of secondary market transactions in FTRs. The ISO does not believe those price caps are appropriately applied to the trading of FTRs. While FTRs do afford scheduling priority to their registered owners in certain circumstances (see Section 9.7), they primarily provide financial protection. Moreover, unlike point-to-point rights under a pro forma tariff, FTRs are not initially priced on the basis of the transmission provider's facility costs or opportunity costs, but on market-clearing prices. In these circumstances, the ISO does not believe that secondary market transactions in FTRs should be subject to a price cap.

Second, the Commission should provide guidance regarding whether an FTR Holder's resale of FTRs in the secondary market constitutes a sale of transmission service that is subject to the Commission's jurisdiction under Part II of the Federal Power Act (to the extent an FTR Holder is a public utility). As explained above, FTRs carry rights that are distinct from the physical transfer rights of point-to-point transmission customers, although those rights include scheduling priority in certain circumstances. If the Commission concludes that the resale of FTRs is subject to the Commission's jurisdiction, it should provide guidance regarding the means by which an FTR holder can satisfy the Commission's requirements applicable to such transfers.<sup>6</sup>

Third, the Commission should provide guidance regarding how the requirements of its regulations regarding OASIS posting would apply to secondary market transactions in FTRs. The Commission's regulations require transmission providers to make their OASIS available for transmission customers seeking to resell transmission capacity. See 18 C.F.R. § 37.6(c)(6). Section 9.8.3 provides that, upon request of an FTR Holder, the ISO will post information on WEnet to facilitate secondary market transactions in FTRs. The ISO requests guidance regarding whether these provisions satisfy the requirements of the Commission's OASIS regulations.

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<sup>5</sup> *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540, 21,576 (May 10, 1996), FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,036 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), III FERC Stats. & Regs. ¶ 30,048 (1996), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *appeals pending*.

<sup>6</sup> See *Enron Power Marketing, Inc.*, 81 FERC ¶ 61,277 (1997).

**Proposed Effective Date and Request for Expedited Consideration**

The ISO respectfully requests the Commission to give Amendment No. 9, as revised, expedited treatment as necessary to issue an order on this filing by no later than January 29, 1999. As explained above, the ISO needs to commence the auction process by February 1999 so that FTRs can be issued before April 1, 1999, to take effect for the balance of the year. For the same reason, the ISO proposes an effective date for Amendment No. 9, as revised, of February 3, 1999, which allows a notice period of 60 days.

An additional copy of this filing is enclosed to be marked with your filing stamp and returned to our messenger.

Respectfully submitted,

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