

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System)
Operator Corporation) Docket No. ER98-3594-000

**MOTION FOR LEAVE TO FILE ANSWER AND
ANSWER TO MOTIONS TO INTERVENE, COMMENTS AND PROTESTS**

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213 (1997), the California Independent System Operator Corporation ("ISO") submits this motion for leave to file an answer and answer to the motions to intervene, comments and protests filed in this docket.

I. BACKGROUND

The ISO's Filing

On June 30, 1998, the ISO filed with the Commission Amendment No. 9 to the ISO Tariff.¹ Amendment No. 9 adds new Sections 9.1 through 9.8 to the tariff, governing the issuance and use of Firm Transmission Rights ("FTRs"), in compliance with the Commission's direction in earlier orders.² FTRs are designed to enable customers under the ISO Tariff to obtain protection against fluctuations in Usage Charges, which are payable by customers seeking to deliver Energy over a congested Inter-Zonal Interface. By purchasing FTRs in

¹Capitalized terms not otherwise defined in this pleading are used in the senses defined in the Master Definitions Supplement, Appendix A to the ISO Tariff.

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

the auctions that the ISO will hold at least annually or in secondary markets, a customer will obtain a contractual entitlement, governed by the terms of the ISO Tariff, to share in the Usage Charge revenues received by the ISO with respect to the Inter-Zonal Interface and direction of flow for which the FTR is defined. The holder of an FTR (the "FTR Holder") can thereby hedge the risk of fluctuating transmission congestion charges. In addition, the proposal affords Day-Ahead priority to schedules submitted by FTR Holders (if the FTR Holder chooses to exercise that priority) when the ISO must resort to non-economic curtailments to manage congestion. The proposal thus contemplates FTRs that embody a financial right and, under certain circumstances, a scheduling priority that is similar to a physical right.

The ISO explained that the FTR proposal reflected in Amendment No. 9 is the product of a process that was characterized by heavy involvement of interested stakeholders, including the consideration of the FTR proposal at three meetings of the ISO's Board of Governors. In addition, the ISO solicited the advice of the independent Market Surveillance Committee with respect to the market power issues that may arise under different approaches to firm transmission rights.

The ISO's initial FTR filing included detailed Tariff provisions that implement the FTR proposal approved by the ISO's Board of Governors. The ISO explained, however, that time did not permit the development of the details of the auction process through which FTRs will be issued. The ISO plans to submit a supplemental filing later this month with the details of that process.

Interventions and Associated Pleadings

Numerous parties submitted motions to intervene in this proceeding.³ The California Commission, the California Electricity Oversight Board and other intervenors indicated their general support for the FTR proposal embodied in Amendment No. 9. Other parties accompanied their interventions with comments or protests challenging the details of particular tariff provisions and, in some cases, fundamental underpinnings of the FTR proposal.

The ISO does not oppose the intervention of any of the parties that have sought leave to intervene in this proceeding. With respect to parties that have raised questions about the wording or functioning of particular provisions of Amendment No. 9, or about the interaction of Amendment No. 9's provisions with other sections of the ISO Tariff, the ISO proposes to study those questions

³The California Public Utilities Commission ("California Commission") submitted a notice of intervention. Motions to intervene were filed by the Bonneville Power Administration ("Bonneville"), California Department of Water Resources, California Electricity Oversight Board, CalEnergy Co., Inc. ("CalEnergy"), California Manufacturers Association and California Large Energy Consumers Association ("CMA/CLECA"), California Municipal Utilities Association, California Power Exchange ("PX"), Cities of Redding, et al. ("Redding"), City and County of San Francisco ("San Francisco"), City of Vernon, Duke Energy Moss Landing, LLC, Duke Energy Trading & Marketing, LLC, Electric Clearinghouse, Inc., Energy Producers & Users Coalition/Cogeneration Association of California ("EPUC/CAC"), Enron Power Marketing, Inc., Los Angeles Department of Water & Power ("LADWP"), Metropolitan Water District of Southern California ("MWD"), Modesto Irrigation District, Member Systems of the New York Power Pool, Northern California Power Agency ("NCPA"); Sacramento Municipal Utility District ("SMUD"), San Diego Gas & Electric Company, Southern California Edison Company ("SCE"), Transmission Agency of Northern California ("TANC"), Turlock Irrigation District ("Turlock"), and the Western Area Power Administration.

further and, if appropriate, to include modifications to Amendment No. 9 as part of its supplemental filing to present the proposed auction process. In this Answer, the ISO will respond to the challenges that have been raised to the basic approach to FTRs set forth in Amendment No. 9. As explained below, those challenges are unfounded.

I. MOTION FOR LEAVE TO FILE ANSWER TO PROTESTS

Some of the intervenors have presented their views on the FTR proposal in pleadings styled as comments; others have styled their pleadings as protests. The ISO respectfully suggests that its responses to all of these concerns should be considered by the Commission, regardless of the different labels to the pleadings. Notwithstanding Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), the Commission has accepted answers to protests that assist the Commission's understanding and resolution of the issues raised in a protest, Long Island Lighting Co., 82 FERC ¶ 61,052 (1998), clarify matters under consideration, Arizona Public Service Co., 82 FERC ¶ 61,132 (1998); Tennessee Gas Pipeline Co., 82 FERC ¶ 61,045 (1998), or materially aid the Commission's disposition of a matter, El Paso Natural Gas Co., 82 FERC ¶ 61,052 (1998). The ISO's Answer will clarify matters under consideration, aid the Commission's understanding and resolution of the issues and help the Commission to achieve a more accurate and complete record, on which all parties are afforded the opportunity to respond to one another's concerns. Northern Border Pipeline Co., 81 FERC ¶ 61,402 (1997); Hopkinton LNG Corp., 81 FERC ¶ 61,291 (1997). The Commission should accordingly accept this Answer.

II. ANSWER

As explained above, the ISO will respond in this Answer to challenges raised by some parties that go to basic concepts embodied in the ISO's FTR proposal. Other concerns raised in the interventions, which go to specific tariff drafting or similar implementation issues, will be addressed, if necessary, in the supplemental filing that the ISO will make to detail the auction process.

A. **The ISO Tariff, Including the FTR Proposal, Will Give Customers Service As Good As, or Superior to, Service Under the Pro Forma Tariff.**

The Commission directed the ISO to present an FTR proposal that, among other things, "enable[s] transmission customers to secure transmission service that is as good as or superior to service under the Order No. 888 pro forma tariff." July 30th Order, 80 FERC at 61,427. At the same time, the Commission recognized that the ISO Tariff incorporated a different approach to transmission service and stated that it "would allow the ISO flexibility in proposing a plan that accomodates the needs of market participants and complements California's new market structure." Id. The Commission thus recognized that a proposal to add a system of FTRs to the ISO Tariff would not necessarily duplicate transmission service under the Order No. 888 pro forma tariff. This was confirmed when the Commission unambiguously stated that the ISO was authorized to base an FTR proposal either on financial rights or on physical rights. October 30th Order, 81 FERC at 61,486. The Commission also noted that a transmission rights proposal could reasonably be based on rights of limited duration:

For example, the ISO could limit the terms of transmission rights that are initially issued to limit the risk exposure of acquiring rights. Moreover, a limited initial term would provide market participants

with experience from which to form a better estimate of the value of longer term transmission rights acquired later.

July 30th Order, 80 FERC at 61,428. Nonetheless, several intervenors protest that unless the ISO Tariff provides for firm physical transmission rights, service under the ISO Tariff will necessarily be inferior to service under a pro forma transmission tariff.¹ Others similarly assert that FTRs are inferior to firm Point to Point (“PTP”) service under the pro forma transmission tariff and discriminate against customers with long-term transactions, primarily because PTP service, unlike FTRs, can last for more than one year.²

Although a system of physical transmission rights, such as the system erected by the Order 888 pro forma tariff, is certainly feasible and was seriously considered by the ISO and the stakeholders, these complaints go too far when they argue that no other approach can meet the needs of market participants.³ These attacks on the approach adopted in Amendment No. 9, which combines aspects of both financial and physical rights, suffer from a number of defects. They ascribe more price certainty to pro forma transmission service than the pro forma tariff actually provides and ignore preconditions to transmission access under the pro forma tariff that are not present under the ISO Tariff. Moreover, they misinterpret the Commission’s directive by comparing FTRs -- in isolation

¹CalEnergy Motion at 5-6; Redding Motion at 12-15; TANC Motion at 12-15.

²Bonneville Motion at 5-13; Electric Clearinghouse Motion at 4.

³These intervenors incorrectly read the Commission’s specification of transmission service “as good as or superior to” service under a pro forma tariff as requiring the ISO Tariff’s transmission provisions to duplicate the pro forma tariff. The Commission made it clear, however, that no such requirement was imposed or intended. July 30th Order, 80 FERC at 61,427. The Commission’s acceptance of a transmission service approach in the ISO Tariff that departs from the pro forma model was consistent with its stated readiness “to accept other tariff designs that further the goal of fostering robust competition in the bulk power market.” Capacity Reservation Open-Access Tariffs, Notice of Proposed Rulemaking, 61 Fed. Reg. 21847, FERC Stats. & Regs. ¶ 32,519 at 33,228 (Apr. 24, 1996). See also Pennsylvania-New Jersey-Maryland Interconnection, 81 FERC ¶ 61,257 at 62,241 (1997) (accepting changes to pro forma tariff in regional transmission tariff that “will foster the creation of more competitive bulk power markets, help to ration constrained capacity among competing transactions on the basis of price, and simplify the reassignment of transmission capacity. . . . consistent with our policy goals in the Open Access Rule.”)

from the other aspects of the ISO Tariff -- to their view of pro forma transmission service or discount unduly the benefits of other aspects of the ISO Tariff.⁴ The Commission, however, recognized that:

. . . the transmission service in the restructured California market will be provided through a set of rights and relationships that are very different from those underlying the traditional models of physical rights which formed the basis of our pro forma Tariff.

July 30th Order, 80 FERC at 61,427. It called for a comparison between pro forma service and service under the ISO Tariff, taking into account all aspects of that service, including but not limited to the FTR proposal. *Id.* Appropriately compared, service under the ISO Tariff, including the proposed FTR provisions, is as good as or superior to service under a pro forma-based tariff.

Under the pro forma tariff, a potential firm customer must apply for firm transmission service, which is made available only if its transaction can physically be transmitted on the transmission owner's ("TOs") system using transfer capability that is not being used to meet the TO's native load requirements or to satisfy obligations under pre-existing transmission and power sales contracts and earlier requests for tariff service.⁵ If sufficient transfer capability is not available to satisfy the request, the prospective customer is

⁴Redding, for example, complains that Amendment No. 9 causes transmission service under the ISO Tariff to diverge from the types of transmission service available from other transmission providers in the Western System Coordinating Council ("WSCC"). Redding Motion at 16. This divergence, however, is not a result of Amendment No. 9, but of the Commission's approval of a different approach to transmission service under the ISO Tariff. The Commission did not require the ISO to submit an FTR proposal that eliminates those differences, but one that provides increased price certainty to customers, in the context of the different model for transmission service that the Commission approved for the restructured California market. July 30th Order, 80 FERC at 61,427.

⁵See Pro Forma Tariff, §§ 2.1, 13.5, 15.2. Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 61 Fed. Reg. 21540, 21709-21724 (1996), Order on Reh'g, Order No. 888-A, 62 Fed. Reg. 12274, Order on Reh'g, Order No. 888-B, 62 Fed. Reg. 64688, Order on Reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

denied service until capacity can be expanded (if the request is for long-term firm service). Id., §§ 15.4, 15.5.

Service under the pro forma tariff, whether long-term or short-term, does not carry with it the price certainty claimed by the advocates of a physical rights model. The pro forma tariff reserves to the TO the right to file to increase the embedded cost rates whenever it likes. Id., § 9. Customers that have already applied for or commenced service are not immune from price increases. In addition, a PTP customer can be liable for redispatch or other opportunity costs if those costs exceed the embedded cost rate in any year of a transaction.⁶ Network customers are required to pay a pro rata share of redispatch costs in addition to a load ratio share of the TO's embedded costs. Pro Forma Tariff, §§ 33.3; 34.4. In sum, while the availability of long-term service under the pro forma tariff assures a customer of access – when excess capacity is available – it does not assure the customer of price certainty.

The ISO Tariff uses a fundamentally different approach, under which transmission capacity is assigned to those who value it the most. Access to the ISO Controlled Grid is made available on a non-discriminatory basis for all transactions scheduled by Scheduling Coordinators (“SCs”). An SC does not need to apply separately to assure itself of access for particular transactions, regardless of their duration. The SC is assured that its transactions will have the same priority as those of other transmitting entities, except for certain of the Existing Contracts that predate the ISO, and, in certain circumstances, those holding FTRs. In the case of Inter-Zonal Congestion, SC transactions with no FTR tie-breaker priority will be subject to curtailment only on a pro rata basis with other SCs that have not acquired FTRs and have not voluntarily accepted

⁶Id., § 27; Order No. 888, 61 Fed. Reg. at 21601; Florida Power & Light Co., 66 FERC ¶ 61,227 (1994).

adjustments to load or generation through Adjustment Bids. Alternatively, SCs can submit Adjustment Bids to assure themselves of the financial equivalence of the delivery of their transaction, notwithstanding Inter-Zonal Congestion. In this system, FTRs are not the mechanism for a customer to obtain access to the transmission system; rather, FTRs provide a tool for customers that have already secured transmission access to “hedge the risk of fluctuating transmission congestion charges,” and the risk that curtailments on a non-economic basis may be required.⁷

The proper comparison thus is between pro forma service, which requires an individual access decision, which is subordinate to usage for native load, and which still exposes the customer to the risks that transmission rates will change and the customer may be assessed congestion costs; and service under the ISO Tariff, including the FTR proposal, which grants equivalent access to all participants, without a native load preference (except where Existing Contracts are involved), allows customers financial protection against congestion costs and provides limited physical delivery rights. Appropriately compared, it is plain that transmission service under the ISO Tariff, with FTRs as proposed, is as good as or better than pro forma transmission service.

This comparison is not undermined by the fact that FTRs will have a maximum duration of one year.⁸ The one-year duration of FTRs does not deny or limit access to the ISO Controlled Grid for long-term transactions. Rather, it enables market participants to secure financial protection against fluctuating congestion charges based on reasonably current assessments of the value of the protection and without locking themselves into long-term commitments, and it

⁷Bonneville’s complaint (Motion at 6) that a customer may only request service under the ISO Tariff once each year is thus misplaced, because the FTR auction is not the means by which a customer initiates transmission service.

⁸FTR Holders will be able to resell portions of their FTRs in secondary markets. This should result in the availability of FTRs covering periods less than one year.

does so without limiting access to the grid. As the Commission stated, this feature of Amendment No. 9 “limit[s] the risk exposure of acquiring [firm transmission] rights.” July 30th Order, 80 FERC at 61,428.

Limiting FTRs to a maximum duration does not discriminate against or disadvantage long-term transactions, as Bonneville claims. Regardless of the duration of its transaction, a customer can gain access to the ISO Controlled Grid without acquiring FTRs. Regardless of the duration of its transaction, a customer can bid to acquire FTRs in the ISO’s auctions or can trade for them in secondary markets. If the duration of FTRs were unlimited, in contrast, a customer with a long-term transaction could lock up the available pool of FTRs for a given interface, leaving none for other customers, including those who enter into later long-term transactions.⁹ As discussed below, the one-year maximum duration of FTRs is one of the means by which the ISO has sought to limit the potential for any market participant to hoard FTRs and in this way to increase competitive opportunities. Hoarding, if it occurs, could injure other customers with long-term transactions as well as those with short-term transactions. The one-year maximum duration for FTRs balances considerations of flexibility and certainty in a way that permits the market participants to engage in transactions of whatever duration they deem appropriate. Especially in light of the lack of experience with impact of introducing FTRs into the restructured California transmission service model, it is appropriate initially to limit the duration of FTRs so that customers are not required to make long-term commitments in the face of substantial uncertainty.

The ISO notes that other parties oppose or express concern about the limited physical priority rights that have been incorporated in the FTR Proposal.¹⁰

⁹The Commission noted the potential for discrimination between new market participants and those with existing long-term transmission contracts. July 30th Order, 80 FERC at 61,427.

¹⁰See CMA/CLECA Motion at 5; LADWP Motion at 4.

The Governing Board of the ISO endeavored to address the competing concerns of those stakeholders favoring financial rights only and those insisting on physical delivery priorities. It did so through a proposal that combines financial rights with physical “tie-breaker” rights and that introduces FTRs on a limited basis, to enable the market participants to gain familiarity with the risks and benefits of FTRs and to enable the ISO Staff and the Market Surveillance Unit to monitor the results of the FTR program on their ability to operate the ISO Controlled Grid safely and efficiently and to detect the exercise of market power. It is appropriate to maintain this balanced approach in the absence of a compelling demonstration that transmission service under the ISO Tariff, including the availability of FTRs, is inferior to pro forma transmission service. The ISO submits that the advocates of a pure physical rights approach have not made such a showing.

B. Some Complaints or Suggestions Are Based on Misunderstandings Concerning the Role of FTRs Under the ISO Tariff.

A number of the complaints regarding Amendment No. 9 similarly misconstrue FTRs as a stand-alone mechanism for transmission access and pricing, rather than an enhancement to the overall transmission approach embodied in the ISO Tariff.

CalEnergy and Electric Clearinghouse, for example, claim that the retention by the ISO’s Board of Governors of discretion to determine the number of FTRs that will be issued (within the limits set forth in Section 9.3.1) is tantamount to the withholding of available transfer capacity by a transmission provider operating under a pro forma-based tariff.¹¹ As explained above, however, FTRs are not necessary for access to the ISO Controlled Grid. As the Commission has found, the ISO Tariff provides open and non-discriminatory

¹¹CalEnergy Motion at 6-7; Electric Clearinghouse Motion at 4.

access, October 30th Order, 81 FERC at 61,455-56; ISO Tariff § 2.1.1; FTRs are not a requirement for transmission access but a means of allowing customers to manage the economic consequences of Inter-Zonal Congestion. As explained below, the ability of the ISO Board of Governors to adjust the quantity of FTRs issued for each interface enables the ISO to respond if unanticipated problems result from the introduction of FTRs or to expand the program if the safeguards that have been incorporated into the program prove adequate. The broad representation of stakeholders on the ISO Board ensures that adjustments to the initial release of 25 percent of uncommitted interface capacity -- whether upward or downward -- will take all interests into account.

CDWR raises a concern with respect to distributing the proceeds of FTR auctions on the basis of the firmness of their pre-existing contractual transmission service.¹² It mischaracterizes the FTR proposal, however, when it speaks of FTRs “derived from converted transmission rights,” suggesting that entities that convert non-firm contract rights to ISO transmission service should receive partial FTRs.¹³ FTRs are not derived from converted transmission rights and do not accrue to holders of Converted Rights. Rather, FTRs are acquired in the auctions held by the ISO or through secondary markets; holders of Converted Rights share in the proceeds of FTR auctions, but do not obtain FTRs by virtue of converting rights under existing transmission contracts. .

TANC complains that the FTR proposal does not address Intra-Zonal Congestion.¹⁴ This feature of the FTR proposal appropriately reflects the fact that Usage Charges are only assessed with respect to Inter-Zonal Congestion. An

¹²CDWR Motion at 3-5. The ISO also notes NCPA’s statement that greater assurance regarding the entitlement of holders of Converted Rights to share in the proceeds of FTR auctions will encourage entities still using Existing Contracts to convert them to ISO Transmission Service. NCPA Motion at 4-5. The ISO will clarify the provisions of Amendment No. 9 affecting the distribution of FTR proceeds as part of the August supplemental filing.

¹³CDWR Motion at 3.

¹⁴TANC Motion at 14.

FTR defined for Intra-Zonal Congestion would serve no purpose as a hedge against liability for Usage Charges. All SCs pay the redispatch costs associated with ISO's use of Adjustment Bids and RMR units to resolve Intra-Zonal Congestion. The Commission's pro forma tariff provides for similar charges in sections 33.3 and 34.4.

Finally, although San Francisco uses the FTR proposal as an occasion to renew its claims that the ISO Tariff results in "and" pricing, the Commission has already considered and rejected these arguments.¹⁵ The addition of the FTR proposal does not require any transmission customer to pay an embedded cost rate plus the incremental congestion costs associated with its particular transaction. Rather, an SC delivering energy across a congested Inter-Zonal Interface pays Usage Charges reflecting a share of the associated congestion costs. The availability of FTRs provides a means for the SC to receive a share of the Usage Charge revenues, thereby reducing its exposure to responsibility for Usage Charges and reducing further the force of any claim that the ISO Tariff imposes "and" pricing.

C. The FTR Proposal Is Structured To Preserve the ISO's Ability To Operate the Grid Efficiently and To Address the Potential for the Exercise of Market Power.

Several intervenors raise concerns regarding the possibility that market participants might use FTRs to exercise market power or that the trading of FTRs in secondary markets might limit the ability of the ISO's Market Surveillance Unit to detect the exercise of market power.¹⁶ The ISO shares these concerns, which were discussed at length in the stakeholder process that preceded the filing of

¹⁵San Francisco Motion at 4-5; July 30th Order, 80 FERC at 61,429-30.

¹⁶PX Motion at 3-8; SCE Motion at 8-9; MWD Motion at 23-24; TANC Motion at 22-23; Electric Clearinghouse Motion at 7

Amendment No. 9. In particular, some of the stakeholders were concerned that the availability of the financial hedge represented by FTRs would reduce the incentive of SC's to submit Adjustment Bids, increasing the likelihood that the ISO would be unable to manage Inter-Zonal Congestion efficiently on an economic basis (i.e., via Adjustment Bids). The ISO staff also expressed the concern that its ability to operate the system could be adversely affected if it were required to keep track of and respect physical priority rights in the Hour-Ahead Market and in real-time operation of the grid.

The FTR proposal addresses these concerns in a number of ways:

- The proposal reserves to the ISO Board of Governors discretion regarding the quantity of FTRs that will be issued on each interface and the Board voted initially to issue FTRs for only 25% of the rated capacity of each interface that is not committed to existing contract rights. The transmission transfer capability adopted is based on the non-simultaneous WSCC rating of the interface, which is usually much higher than the lines' operating limit. By limiting the amount of FTRs that are available at the outset, the ISO Board gives market participants and the ISO itself the opportunity to evaluate the impact of a limited release of FTRs before implementing a more expanded program. The limitation is designed to reduce the risk that the ISO will not be able to use Adjustment Bids to manage congestion and to limit the potential for FTR Holders to increase congestion levels artificially through gaming strategies. The preservation of Adjustment Bids would also help ensure the existence of transparent prices for congestion relief. By retaining the discretion to adjust the quantities of FTRs issued, the ISO will be able both to impose further restrictions, if necessary, or to expand the program rapidly, if experience shows that FTRs can be introduced without impairing the ISO's ability to manage congestion and the ability of the ISO's Market Surveillance Unit to detect the exercise of market power.
- As noted above, the maximum duration of FTRs issued by the ISO is limited to one year. This is another mechanism designed to promote the wide availability of FTRs and to limit the opportunities and incentives for any market participant to hoard the available FTRs for an interface.

- While the proposal lets FTR Holders share in Usage Charge revenues resulting from the Day-Ahead Market and the Hour-Ahead Market, it limits the physical “tie-breaker” rights to the Day-Ahead Market. This “use it or lose it” feature of the FTR proposal is another means designed to preserve the incentive for SC’s to submit Adjustment Bids. It also addresses the operability concerns that were expressed by the ISO staff during the stakeholder discussions.
- The proposal provides that FTR Holders may trade FTRs in secondary markets without the knowledge or participation of the ISO, unless the transferee wishes to exercise the physical tie-breaker rights associated with the FTRs it acquires. This feature is designed to enhance the marketability, and therefore the value, of FTRs while limiting the administrative burdens on the ISO. It also allows maximum room for FTR trading mechanisms to be developed that meet the needs of market participants. At the same time, the other aspects of the proposal that encourage the continued submission of Adjustment Bids should preserve the availability of transparent pricing for congestion relief.

While some intervenors challenge these restrictions on the FTR proposal, urging the more rapid introduction of FTRs or the addition of expanded physical priority rights,¹ the ISO believes that these features provide important protections to ensure, at this early stage of the ISO’s operation, that FTRs are introduced under conditions that serve the objectives of the ISO’s market structure.

As the ISO explained in its transmittal letter, an integral part of the FTR proposal is the commitment of the ISO and its Market Surveillance Unit to study the effect of the introduction of FTRs on the ISO’s ability to operate the grid reliably and efficiently, on the robustness of the Adjustment Bid market, and on the ability of market participants to exercise market power. In particular, that monitoring will include evaluation of whether the availability of FTRs leads to the types of gaming feared by the PX to increase congestion costs to the benefit of FTR holders. The proposal intentionally proceeds cautiously in the initial introduction of FTRs, to enable the ISO and the market participants to learn from

¹See n. 4 and n. 5, above, and Electric Clearinghouse Motion at 3-5, CDWR Motion at 6..

experience, and to provide for the expansion of the issuance of FTRs only on conditions that assure that these objectives are not compromised. If the ISO's monitoring of the effects of FTRs reveals problems with the proposal, the ISO will propose necessary changes to the provisions included in Amendment No. 9.

The ISO in no way seeks to dismiss the validity of the concerns expressed by the intervenors regarding the potential for FTRs to create opportunities for gaming or the exercise of market power. The FTR proposal, however, was structured to take those concerns into account and the ISO believes that the aspects of the FTR proposal discussed above, coupled with the commitment to monitor the impact of FTRs on the ISO's markets, are adequate to address them.

D. The FTR Proposal Appropriately Denominates FTRs on a Firm MW Basis.

Amendment No. 9 specifies that FTRs will be denominated in whole megawatts, rather than as a percentage of the capacity of the interface for which they are defined. Section 9.2.4. When the scheduling capability of an interface is reduced, as sometimes happens as a result of operating conditions, the rights of FTR Holders to share in congestion revenues will remain constant, on a MW basis, unless the reduction eliminates all scheduling capability available to customers that have not acquired FTRs. Section 9.6.3. Some intervenors challenge this provision, claiming it inappropriately favors FTR Holders at the expense of Participating TOs and their customers, who will have a greater exposure to a reduction in their share of congestion revenues than FTR Holders.¹ This claim ignores the fact that the Participating TOs whose facilities and rights comprise an interface will receive the proceeds of the auction of FTRs on that

¹SCE Motion at 3-4, SMUD Motion at 4-6. NCPA raises a similar claim, referencing Section 9.7.2.1. NCPA Motion at 11. That provision, however, deals with the exercise of physical tie-breaker rights by FTR Holders, not with the distribution of congestion revenues.

interface. Preserving the MW value of those FTRs is designed to enhance their marketability, consistent with the Commission's directive in the July 30th Order (80 FERC at 61,427), and therefore the price they bring at auction. While the Participating TOs may receive a smaller share of congestion revenues than if the entitlements of FTR Holders fluctuated with changes in interface capacity, they should receive larger amounts from the FTR auction. Conversely, if the financial rights associated with FTRs were subject to adjustment based on changes in the scheduling capability over an interface, that uncertainty would be reflected in lower prices and less revenues to Participating TOs.² The FTR proposal thus enhances the usefulness of FTRs to market participants while protecting the interests of the Participating TOs and their customers in receiving Usage Charge revenues or the proceeds of FTR auctions in compensation for their transmission facilities and rights.

E. Complaints Regarding the FTR Auction Design Are Premature.

Several intervenors challenge the ISO's failure to incorporate into the proposed Section 9.4 principles regarding the auction process as to which a high degree of consensus was achieved among the working group.³ CAC/EPUC urges the Commission to reject Amendment No. 9 because the details of the auction design were not specified.

These claims are premature. Before the Commission rules on Amendment No. 9, the ISO will have made a supplemental filing to provide the details of the proposed auction process. That filing will moot these concerns. The stakeholders will have an opportunity to ensure that the detailed auction

²SCE's argument (SCE Motion at 4) that Section 9.6.3 cannot function as intended once FTRs are issued for all of the available capacity of an interface is mistaken. The provision specifies that, if the scheduling capacity available to customers without FTRs is eliminated, the financial entitlements of FTR Holders will be proportionately reduced. Section 9.6.3. If more FTRs are made available and sold, that provision will simply become applicable more often. Nevertheless, the firmness of the MW value of FTRs will be preserved to the extent possible.

³TANC Motion at 26-29; CDWR Motion at 1-2.

process is workable and reflects the principles they support and, if they are dissatisfied, to urge changes in response to the ISO's supplemental filing.

CONCLUSION

The ISO does not oppose the intervention in this proceeding of any party that has moved to intervene. For the foregoing reasons, the Commission should: (1) accept the ISO's Answer to the extent it responds to points raised in Protests; and (2) withhold ruling on Amendment No. 9 until the supplemental filing has been submitted.

Respectfully submitted,

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Dated: August 4, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the service list compiled by the Secretary in this proceeding.

Dated at Washington, DC, this 4th day of August, 1998.

Michael E. Ward
Counsel for the California Independent
System Operator Corporation