

June 30, 1998

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

**Re: The California Independent System Operator Corporation,
Amendment to ISO Tariff To Implement Firm Transmission Rights**

Dear Secretary Boergers:

Pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d, and Section 35.13 of the Commission's Regulations, 18 C.F.R. § 35.13, the California Independent System Operator Corporation ("ISO") submits six copies of an amendment, Amendment No. 9, to the ISO Tariff.

The enclosed amendment adds a new Article 9 to the tariff, governing the issuance and use of Firm Transmission Rights ("FTRs"), in compliance with the Commission's direction in earlier orders.¹ FTRs issued in accordance with the enclosed amendment will be freely tradable in secondary markets, will afford transmission service to customers of the ISO that is at least comparable to service under the Order No. 888 *Pro Forma* tariff, and otherwise will satisfy the requirements of the Commission's orders.²

As explained below, the FTR proposal reflected in the enclosed amendment to the ISO Tariff was developed through an open and transparent process involving all interested stakeholders and culminating in the approval of the amendment by the ISO's Board of Governors on June 25, 1998. However, time did not permit completion of the development of one aspect of the FTR proposal: the detailed description of the auction process by which FTRs would be made available. The ISO is obtaining expert advice regarding the design of the auction process and the rules that would apply and, after further consultation with

¹ *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,486 (1997) (the "July 30 Order"); *Pacific Gas & Electric Co., et al.*, 80 FERC ¶ 61,128 at 61,427 (1997) (the "October 30 Order").

² October 30 Order, 81 FERC at 61,486.

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interested stakeholders, will supplement this filing with a detailed auction design. The ISO expects to submit the detailed auction design and rules by the end of August 1998.

NOTICES

Communications regarding this filing should be directed to the following representatives of the ISO, whose names should be placed on the official service list established by the Secretary for this proceeding:

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BACKGROUND AND REASONS FOR FILING

The Commission's Orders

Under the ISO Tariff, customers will incur Usage Charges when they transfer energy over certain Inter-Zonal Interfaces at times when the interfaces are congested.¹ In the June 30 Order, the Commission noted the importance of firm transmission rights as a means of enabling "market participants to hedge the risk of fluctuating transmission congestion charges."² The Commission accordingly directed the ISO to file by June 30, 1998 a plan to make transmission rights available beginning on January 1, 1999. The Commission stated that it would afford the ISO flexibility to develop a transmission rights plan that "accommodates

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

² 80 FERC at 61,427.

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the needs of market participants and complements California's new market structure." *Id.* The Commission specified, however, that a transmission rights plan must meet certain criteria:

- First, the transmission rights proposal, in combination with the other aspects of the ISO Tariff, must enable customers to secure transmission service that is as good as or superior to service under the Order 888 *Pro Forma* tariff;
- Second, the transmission rights proposal should not allow any participant to withhold capacity from the market;
- Third, the transmission rights should be resellable; and
- Fourth, the transmission rights proposal must comply with the Commission's ISO Principles.¹

In the October 30 Order, the Commission confirmed these rulings and clarified that the ISO had the flexibility to develop a transmission rights proposal based either on financial rights or on physical rights.²

Stakeholder Process

The ISO is committed to an open and transparent process for the development of ISO Tariff amendments. The FTR proposal embodied in the enclosed amendment results from an extensive process through which input was sought from all interested parties regarding the appropriate scope and design of a tariff amendment addressing firm transmission rights. Key milestones in that process included the following:

- In March of this year, a working group was established to discuss the development of an FTR proposal. The working group included representatives of investor-owned utilities, publicly owned utilities, marketers, and public interest groups, as well as the ISO. Through a series of meetings and conference calls, and the exchange of proposals and position papers, the working group was able to reach consensus on most issues associated with the FTR proposal.

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Id.

²

81 FERC at 61,486.

- The working group's progress on defining an FTR proposal was discussed at the ISO Board Meeting on April 26, 1998. The Board requested interested stakeholders to prepare white papers describing and supporting their positions on issues as to which consensus was not reached. Those papers were prepared and circulated, and discussed by the working group, over the following weeks;
- The ISO's Market Surveillance Unit was asked to consider and advise the ISO Board of the implications of firm transmission rights, and of different approaches to implementing an FTR proposal, on the ability of market participants to exercise undue market power and on the ability of the ISO to detect the exercise of undue market power;
- At the May 28, 1998 meeting of the ISO Board, there was a full discussion of the issues as to which the working group was unable to reach a consensus, as reflected in the white papers that were circulated, of the views of the ISO's Market Surveillance Unit, and of the views of the ISO's operations department regarding the effect of different approaches to FTRs on the ISO's ability to operate the ISO Controlled Grid reliably and efficiently. Following that discussion, the Board approved a proposal to resolve those issues, which formed the basis for Amendment No. 9;
- Drafts of Amendment No. 9 were prepared by the ISO and circulated to the FTR working group for comment; and
- At its June 25, 1998 meeting, the ISO Board approved the filing of Amendment No. 9 to the ISO Tariff.

THE ISO TARIFF AMENDMENT

Amendment No. 9 adds new Sections 9.1 through 9.8 to the ISO Tariff to govern the creation, distribution and use of FTRs. As defined in the amendment, FTRs have attributes both of financial contracts and of physical transmission rights. As financial contracts, FTRs entitle their owners to share in the distribution of Usage Charge revenues received by the ISO in connection with Inter-Zonal Congestion on the ISO Controlled Grid during the calendar year for which the FTR is issued.¹ As physical rights, the registered holder of an FTR is entitled to priority for the transmission of Energy across a congested Inter-Zonal Interface in the circumstances described in the amendment. See Section 9.7.

FTRs are defined separately for each transmission path from an originating zone to a contiguous receiving zone. The ISO Board will designate the amounts of

¹ See Section 9.6. Currently, the Usage Charge revenues are distributed to Participating Transmission Owners owning the transmission facilities or rights making up an Inter-Zonal Interface. Proceeds of the ISO's auction of FTRs will be distributed in the same manner. See Section 9.5.

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FTRs that will be made available through an annual auction for each interface. See Sections 9.2.3, 9.3.1. The ISO Board has decided that, for the first auction of FTRs, the ISO will issue a number of FTRs that equals one-fourth of the portion of the WSCC Approved Rating of each transmission path that is not subscribed by existing transmission rights.

Each of these foregoing attributes of the FTR proposal represents a compromise, approved by the ISO's Governing Board, of divergent positions expressed during the stakeholder process. Some participants in that process favored purely financial FTRs; others advocated FTRs that gave their holders physical priority for transactions. Different views were expressed regarding how to measure the amount of available transmission capacity as well as how much of that available capacity should initially be allocated to FTRs. The stakeholder process resulted in a compromise proposal that is reflected in the amendment.

An integral part of the compromise proposal is the commitment by the ISO to study the effect of the issuance of FTRs on the ISO's ability to operate the grid reliably and efficiently, to manage congestion using market-based mechanisms, such as Adjustment Bids, and to detect the abuse of market power. Concerns in each of these areas were expressed during the stakeholder process, while other participants expressed the view that problems were unlikely. The ISO Governing Board decided to proceed on the basis of the compromise proposal and will conduct a monitoring study. Should it become necessary to do so, the ISO can propose changes in any of the provisions of Article 9 in accordance with Section 19 of the ISO Tariff.

The amendment specifies that FTRs will be made available through an auction process and will be available to any entity satisfying the applicable financial criteria (except the ISO itself). See Sections 9.2.7, 9.4. Section 9.4 describes generally the multi-round clearing price auction that will be used to issue FTRs. The ISO is in the process of obtaining independent expert advice regarding the detailed design and implementation of the auction. Following the review of that advice by the ISO and interested stakeholders, the ISO plans to supplement this filing by submitting details of the auction design to the Commission. The ISO expects to make that supplemental filing in late August 1998 following the ISO Board meeting.

CONSISTENCY OF THE PROPOSAL WITH THE COMMISSION'S REQUIREMENTS

As noted above, the Commission set forth certain requirements for a transmission rights proposal in the June 30 Order.² Those requirements informed the deliberations of the working group through which the compromise proposal approved by the ISO Governing Board and reflected in Amendment No. 9 was developed. That proposal represents a reasonable approach that satisfies the Commission's requirements.

1. Comparison to *Pro Forma* Transmission Service.

Transmission service under the Order 888 *Pro Forma* tariff enables transmission customers to obtain fixed-price point-to-point firm transmission service. The FTRs would enable a participant to obtain comparable service on the ISO controlled grid. In order to provide accurate price signals with regard to the use of congested transmission facilities and the siting of generation, the ISO Tariff assesses congestion-based Usage Charges to those transmission customers that use congested transmission paths. The potential for the network to experience congestion creates price uncertainty, and the availability of FTRs provides a means for the transmission customer to protect itself against that uncertainty. The entitlement to the payment of Usage Charge revenues, together with scheduling priority when the ISO is required to curtail schedules on a non-economic basis in the Day-Ahead Market, provides holders of FTRs both with a price hedge against congestion costs, and with scheduling protection that is at least comparable to the protection afforded by fixed-price transmission service under a *Pro Forma*-based tariff.

2. Capacity May Not Be Withheld.

The FTR proposal does not permit the withholding of the day-ahead scheduling priority right associated with FTRs. Any capacity subject to such priority right not utilized in the Day-Ahead scheduling process will become available to all transmission users. Specifically, as stated in section 9.7.1 of the proposed amendment, any FTRs not used in Preferred Schedules in the Day-Ahead Market for any hour have no scheduling priority for that hour in the trading day. That is, FTR Holders shall have no scheduling priority in the Hour Ahead Market or in real-time operations and therefore will be unable to withhold transmission capacity from the market.

² June 30 Order, 80 FERC at 61,427.

3. FTRs Are Resellable.

The FTR proposal specifies that FTRs will be freely transferable. Pursuant to section 9.8 of the amendment, any FTR Holder may assign, sell or transfer all or a portion (in full MW increments) of its FTR, either for the full period of the FTR or for a shorter period (but in full hour increments). The proposed amendment also provides that FTR Holders may register the transfer of their FTRs with the ISO, specifying the quantity and identification numbers of the FTRs being transferred. In order to use the Scheduling Priority of an FTR, an FTR must be registered with the ISO. All notices must be submitted before the deadline applicable to the scheduling of Energy in the Day-Ahead Market in order for the transferee to exercise the Scheduling Priority associated with the transferred FTR.

All information regarding the amount and price of FTRs sold in the primary auction will be posted on the WENet by the ISO. In addition, the ISO will post information to aid in the development and operation of secondary markets for FTRs. Section 9.8.3 of the proposed ISO Tariff amendment provides that the ISO will post on WENet the identity of entities that obtained FTRs that have been registered with the ISO, together with the quantity and identification numbers of the FTRs obtained by such entities. The ISO will also post, upon request of such party, the name and a contact telephone number or telecopy number of any entity that operates a secondary market in FTRs. ISO management is currently evaluating the feasibility and appropriateness of posting price information regarding the sale of FTRs in the secondary market(s). Once the ISO and the stakeholders have properly evaluated the necessity and possibility of posting this information, the ISO will inform the Commission on this issue. The ISO currently anticipates that it will complete this process prior to the date on which it will file the details of the FTR auction.

3. The FTR Proposal Is Consistent With the ISO Principles.

The Commission stated that the ISO's transmission rights proposal should be consistent with the Commission's ISO principles. Specifically, the July 30 Order focused on Principle Nos. 6 and 8. Principle No. 6 states that an ISO should identify and manage congestion through rules that promote efficient trading. Principle No. 8 states that an ISO's transmission pricing policies should promote the efficient use of and investment in generation, transmission and consumption. 80 FERC at 61,427. The ISO's FTR proposal satisfies these requirements.

The ISO FTR proposal, in conjunction with the ISO Tariff's Congestion Management provisions, will promote efficient trading and the use of and investment in generation, transmission and consumption. By Making FTRs available through an auction process, the ISO will promote the efficient use of constrained transmission interfaces. Market Participants who place the highest value on the ability to use congested transmission facilities at a fixed price can be expected to submit the highest bids. In this way, the capacity of the interface will

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be allocated to the parties that place the highest value on it, thereby promoting efficiency.

The FTR proposal also creates a trading mechanism that complements the ISO's existing mechanism for managing congestion through Adjustment Bids. The allocation of FTRs through an auction and the trading of FTRs through secondary markets will enable Market Participants to hedge the uncertainty created by the potential payment of Usage Charges when transmission facilities are constrained. By creating the fewest possible impediments to obtaining and trading FTRs, the proposal should promote efficient trading. The ISO's proposal satisfies a number of important points raised by the Commission in its previous orders. First, as explained above, the ISO's Congestion Management system efficiently allocates congested or scarce transmission capacity to those users that value it most. Second, the ISO's FTR proposal enables transmission customers to obtain firm transmission service over the ISO Controlled Grid at a known price. Working in conjunction, the FTR proposal and the Congestion Pricing mechanism, provide transmission service that is at least equal, if not superior, to that provided under the Commission's *Pro Forma* tariff.

PROPOSED PROCEDURE AND EFFECTIVE DATE

As noted above, the ISO expects to supplement this filing with a detailed description of the proposed auction process for FTRs, to be filed in August 1998. So that the Commission may complete its review of this filing expeditiously to support the auction of FTRs for 1999, the ISO suggests that the Commission invite interventions and comments on this filing without awaiting the supplemental filing. When the supplemental filing is submitted, intervenors should be permitted (without the necessity of reviewing their interventions) to supplement their comments to address the supplemental filing and its implications for the FTR proposal. In that way, the Commission should be able to complete its review of the filing, as supplemented, sufficiently in advance of the planned start of the auction process to enable that process to proceed without delay.

The July 30 Order specified that the ISO's proposal should make transmission rights available commencing January 1, 1999. To complete the auction of FTRs by that date, the ISO estimates that the auction process must begin by approximately November 1, 1998. In view of the lead-time required to conduct the auction process, and the importance of tariff certainty to the goal of stimulating interest in the auction thereby maximizing auction proceeds, the ISO respectfully requests that the Commission rule on the enclosed amendment by October 31, 1998, making the amendment effective on that date.

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DOCUMENTS SUBMITTED

The ISO submits six copies of the following documents together with this transmittal letter:

- Amendment No. 9 to the ISO Tariff; and
- A form of notice suitable for publication in the Federal Register (in both hard copy and electronic format).

REQUEST FOR WAIVERS

The value of the FTRs issued by the ISO will be determined through an auction, rather than on the costs of any jurisdictional facilities. In addition, as explained in Section 9.5, revenues received by the ISO through the issuance of FTRs will be credited to Participating Transmission Owners. The ISO accordingly believes that the abbreviated filing requirements of Section 35.13(a)(2)(iii) apply to this filing.

In addition, because the ISO has not issued FTRs in the past and there is no basis upon which a reliable estimate of the proceeds of the FTR auctions can be developed, the revenue comparison called for by Section 35.13(c) cannot practically be prepared. The ISO requests waiver of this requirement, as well as of any other requirement of the Commission's regulations that is deemed applicable to this filing and that is not satisfied by the information submitted with this letter.

CONCLUSION

For the foregoing reasons, the California Independent System Operator Corporation respectfully submits the enclosed ISO Tariff amendment and requests the Commission to establish future proceedings as described above so that the Commission may rule on the enclosed amendment by October 31, 1998 to enable the auction process for FTRs to commence in time to permit their issuance effective January 1, 1999.

Respectfully submitted,

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