UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

REQUEST FOR CLARIFICATION AND REHEARING OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713, the California Independent System Operator Corporation ("ISO") requests clarification and rehearing of the Commission's May 3, 1999, Order in the above-captioned proceeding ("the May 3 Order").

Executive Summary

The May 3 Order contained the Commission's authorization and direction for the ISO's implementation of Firm Transmission Rights ("FTRs"). The ISO respectfully seeks clarification and rehearing on two limited issues:

- clarification that the ISO's plan to release 100% of unsubscribed capacity calculated by using historic capacity availability curves with a 99.5 percent availability level (and net of existing contract rights ("ETCs")) meets the Commission's requirement that the ISO calculate FTRs in a way that protects ETCs and offers a high degree of firmness; and

- rehearing of the Commission's timing directives to accommodate Y2K concerns and the practical limitation that software for FTRs will not be complete until late in 1999.

In addition, we seek the remaining guidance deferred in the Commission's May 3 order.

As more fully described below, the ISO believes the calculation of FTRs based on a 99.5% historic availability determination[1] best meets the competing needs of (1) ETC holders whose rights must be protected; (2) market participants who from the inception urged FTRs based on MWs rather than percentages; and (3) the need to preserve the ISO's congestion management system and an active adjustment bid market as a means of checking the exercise of market power.

With respect to the timing, the choices are limited. The ISO's information technology experts advise that implementing any major software in the quarter before Y2K or on January 1, 2000, creates inadvisable risks and is inconsistent with current reliability organization advisories against any software changes after the September 1999 nation-wide testing. As noted in the ISO's letter of March 10, 1999, and its motion of March 26, 1999, the ISO had to select the software platform on which to build final Y2K and Ancillary Services market redesign software by mid-April. When a Commission order on FTRs was not available, the only prudent choice was to use the existing platform and defer until after the summer any FTR implementation. That deferral and the proposed Y2K software freeze during the fourth quarter through January 1, 2000, leave as the only prudent choice a February 1, 2000, implementation date.

[1] At present, the ISO believes 99.5% is the appropriate number. If this results in unreasonably small amounts of available FTRs, ISO management will propose to the Board in advance of the auction a lower historic availability percentage consistent with the needs to protect Existing Contract rights and to provide for a liquid FTR market.

The Board has thus directed management to seek rehearing to allow initial release (of 100% of available FTRs) on February 1, 2000, for a period through March 31, 2001, with the second release to be for a period April 1, 2001, through March 31, 2002. Experience in the summer of 2000 will provide further information to assist in determining how to implement longer-term FTRs and give an opportunity to assess how migration to a regional transmission organization in the West should be accommodated in any longer-term release program.

Background

On June 6, 1998, in compliance with the Commission's direction in earlier orders,[2] the ISO tendered for filing Amendment No. 9 to the ISO Tariff, adding Sections 9.1 through 9.8 to govern the creation, distribution and use of Firm Transmission Rights ("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.[3] As physical rights, FTRs entitle the registered holder to priority for the

[2] *Pacific Gas & Electric Co., et al.,* 81 FERC ¶ 61,122 at 61,486 (1997); *Pacific Gas & Electric Co., et al.,* 80 FERC ¶ 61,128 at 61,427 (1997).

[3] 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.

transmission of Energy across a congested Inter-Zonal Interface in the circumstances described in the amendment.

FTRs are defined separately for each Inter-Zonal Interface and direction of flow combination on the ISO Controlled Grid. Under Amendment No. 9 as filed, the ISO Board would designate the amounts of FTRs that will be made available through an annual auction for each interface. For the first annual auction of FTRs (for FTRs that would have been effective for calendar year 1999), the ISO proposed to issue a number of FTRs equal to one-quarter of that portion of the non-simultaneous rating of the interface (in the relevant direction) that is not subscribed by existing transmission rights. The ISO also committed to study the effect of the issuance of FTRs on the ISO's ability to operate the grid safely, reliably and efficiently, to manage congestion using market-based mechanisms, such as Adjustment Bids, and to detect the abuse of market power. On September 29, 1998, the ISO filed a motion for an extension of time for the implementation of FTRs to March 31, 1999, which the Commission subsequently approved.[4]

On December 4, the ISO tendered a revised version of Amendment No. 9, expanding Section 9.4 to include a detailed description of the auction process which was developed with the assistance of independent consultants. The revision also incorporated a number of other changes in response to comments received on the initial filing. In addition, the ISO requested guidance from the Commission on three questions associated with the operation of secondary

[4] *California Independent System Operator Corp.*, 85 FERC ¶ 61,405 (1998).

markets for FTRs:

(1) Whether the price caps applicable to the reassignment of point-to-point transmission rights obtained under an Order No. 888 pro forma tariff[5] would apply in the case of secondary market transactions in FTRs;

(2) 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), and, if the Commission concluded that the resale of FTRs is subject to the Commission's jurisdiction, guidance regarding the means by which an FTR Holder can satisfy the Commission's requirements applicable to such transfers;[6] and

(3) how the requirements of the Commission's regulations regarding OASIS posting would apply to secondary market transactions in FTRs.

With a letter filed on March 10, 1999, the ISO provided the Commission with a Notice to Market Participants indicating that if the Commission did not issue an order on the ISO's FTR filing by March 31, 1999 (or if the Commission substantively changed the FTR program), the ISO would confer with Market Participants on a recommended course of action. By motion filed on March 26, 1999, the ISO informed the Commission that FTR capability could not be included in the next release of the software being developed to support Y2K

[5] *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*.

[6] *See Enron Power Marketing, Inc.,* 81 FERC ¶ 61,277 (1997).

compliance efforts and the redesign of Ancillary Services markets unless approval of the FTR program were to be received by the end of March. The ISO further informed the Commission that, absent such approval, the need to move forward with the software development would preclude FTR implementation by May 1, 1999, and, if approval were not forthcoming by mid-April, implementation could not be accomplished in time for the 1999 summer peak season.

In the May 3 Order, the Commission approved Amendment No. 9, with certain modifications. While the Commission did not address the timing of the initial release of FTRs, it did direct both the ISO and the Market Surveillance Committee ("MSC") to file reports by October 1, 1999, addressing the initial operation of the ISO's FTR program. May 3 Order, slip op. at 8, 16, 29. In order to expedite implementation of the FTR program, the Commission deferred consideration of the requested guidance. May 3 Order, slip op. at 28.

Specification of Errors

In accordance with Rule 713(c)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(c)(1), the ISO specifies that the Commission should modify and clarify the May 3 Order as follows:

1. The Commission should clarify that the ISO's proposal herein to release FTRs for 100% of the New Firm Use capacity, based on a 99.5% historical availability, as determined from load duration curves for each Inter-Zonal Interface, is consistent with the Commission's order regarding the sale of FTRs for all unsubscribed capacity.

2. Because of the timing of the May 3 Order, the initial release of FTRs must be postponed. The deadlines established in the May 3 Order should be modified to reflect a February 1, 2000, initial release of FTRs.

3. The Commission should provide the guidance that the ISO requested regarding secondary market transactions.

Discussion

I. The Commission Should Clarify that the ISO Proposal Herein to Release Initially FTRs Equivalent to 100% of the 99.5% Probable Available Capacity, Less the Capacity Committed to Existing Contracts, Is Consistent with the Commission's Directive

The ISO's proposal called for an initial issue of FTRs equal to 25% of the WSCC non-simultaneous rated capacity of each path, less that committed to Existing Contracts. The ISO stated its intention to increase that amount, based on experience. The Commission authorized the initial issuance as requested by the ISO, but directed the ISO to increase the issuance of FTRs to 100% of "unsubscribed capacity" by January 1, 2000. May 3 Order, slip op. at 17. The Commission also directed the ISO to review its methodology for determining available capacity, and to report its conclusions to the Commission by October 1, 1999. May 3 Order, slip op. at 16.

At the Governing Board meeting on May 26, 1999, a consensus was reached as to how the ISO can comply with the Commission's concern about making 100% of unsubscribed capacity available for FTRs, while at the same time addressing other concerns regarding the submission of adjustment bids and

the ISO's need to manage congestion on the transmission system.[7] Consistent with the May 3 Order, the ISO would release FTRs equivalent to 100% of the unsubscribed capacity of each interface with the initial auction of FTRs for February 1, 2000. For purposes of determining the unsubscribed capacity of each interface, the ISO would not use the non-simultaneous rating, as initially proposed. Instead, the ISO would use the load duration curves for each interface to determine the amount of capacity that is expected to be available for New Firm Uses (i.e., capacity not committed to Existing Contracts) using a 99.5 percent standard based on historic availabilities.[8] That amount of capacity, representing the unsubscribed firm capacity of the interface, would all be made available as FTRs.

As the Commission's May 3 Order recognizes, a determination of the number of FTRs to release must reconcile a number of competing concerns. On the one hand, market liquidity increases with greater amounts of available FTRs. On the other hand, the ISO must be able to avoid over-allocation of available capacity. The Commission itself noted that released FTRs should represent capacity that enjoys a high degree of firmness. The percentage of capacity

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[7] The ability to manage congestion, obviously, is a key aspect of the market design approved by the Commission. The congestion market is the vehicle to: (1) provide efficient transmission pricing signals, (2) establish zonal prices and to create new zones, and (3) assist in transmission planning by providing locational price signals for new generators.

[8] The figure of 99.5% was arrived at by assessing the number of hours in the last year (40) that the ISO needed to call on interruptible contacts because of transmission capacity restrictions. The total of 40 hours represents approximately 0.5% of the number of hours in the year. Studies are currently underway to determine the number of MWs that will be available on each interface using this standard.

made available and the manner of measuring available capacity necessarily are closely interrelated. Because transmission paths do not operate in isolation, the non-simultaneous rating of a transmission path is likely to overstate the actual capacity of the path (after Existing Contracts are accounted for) under some operating conditions. Releasing FTRs for all of the unsubscribed non-simultaneous capacity of a transmission path is likely to lead to the issuance of more FTRs than can be accommodated under many operating scenarios. In addition, the ISO continues to believe that before moving to the unrestricted release of FTRs, it is advisable to gain experience and to monitor the impact of FTRs on the ability of market participants to exercise market power in other markets.

The ISO recognizes the Commission's concern that available transfer capability not be excluded unnecessarily from the capacity available for release through FTRs. The ISO's proposal is intended to ensure that FTRs have a high degree of firmness and will thereby enhance their value to Market Participants.

Consistently with the May 3 Order, the ISO would submit a study and recommendation to the Commission, based on the experience of the first summer, regarding the effectiveness of this methodology for measuring capacity as a means for allocating FTRs in a manner that will best ensure that all unsubscribed capacity is available to Market Participants. As described above, the ISO recommends that such a report be filed on December 1, 2000.

II. The Commission Should Defer the Deadlines Established in the May 3 Order in Recognition of the Delayed Initial Release of FTRs

The May 3 Order did not explicitly set forth a date by which the

Commission requires that FTRs initially be made available. The Order did, however, establish a number of deadlines premised on the ability of the ISO to issue FTRs before the 1999 summer peak season. For example, the Commission required the ISO to use the experience gained through the initial offering to develop a longer-term FTR product, and to report on its progress by October 1, 1999. May 3 Order, slip op. at 8. Similarly, the MSC was called upon to provide an assessment of the new FTR market by the same date. May 3 Order, slip op. at 29.

The ISO agrees with the importance of using initial experience to guide further development of FTRs. It is no longer possible, however, to implement the initial offering of FTRs in time for the 1999 summer peak season. To assure Y2K compliance, the ISO was required to proceed with a redesign of its software, including the incorporation of the changes required for Ancillary Services market redesign, before the Commission acted on Amendment No. 9.

Preparation of the software needed to implement Y2K compliance measures by the end of the year required significant lead time. The programmers writing the software needed to know by mid-April the underlying software (the "platform") on which the revisions would be overlaid. In the absence of Commission guidance regarding the acceptability of the FTR proposal contained in Amendment No. 9, a decision to prepare the software based on the FTR proposal would have been irresponsible. Had the Commission directed changes to the FTR program that required software modifications, the ISO's ability to ensure Y2K compliance would have been jeopardized.

A similar circumstance prevailed with respect to the software necessary to implement Ancillary Services redesign by the summer (as directed by the Commission[9]). If the software had been designed on a platform including the FTR program as proposed, and the Commission had subsequently directed significant changes in the program, the Ancillary Services redesign could not have been put into place until the fall.

In addition, the ISO previously determined that in order to properly implement FTRs, the ISO must also make certain closely related changes to its software to facility the scheduling and validation of Existing Contracts. Under the ISO's existing scheduling infrastructure, the ISO cannot validate schedules submitted pursuant to Existing Contracts. Therefore, in certain circumstances, Existing Contract schedules may inappropriately receive a priority use of certain transmission paths over which they have no rights. Under the ISO's proposed software revisions, both FTRs and Existing Contracts will be scheduled on a comparable basis.[10] The ISO had intended to upload the software containing both the FTR and the Existing Contract-related code with the FTR implementation.

Until March, the ISO did not anticipate that the Existing Contract-related software revisions would necessitate changes to the ISO Tariff. It is now apparent, however, that certain limited changes to the ISO Tariff will be required.

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9 *AES Redondo Beach, LLC, et al.*, 85 FERC ¶ 61,123 (1998).

10 The validation problem concerning the scheduling of Existing Contract rights is also present for the schedule of FTRs. Thus, the implementation of FTRs should coincide with the implementation of the solution for validating Existing Contract schedules.

It does not appear feasible to complete discussions with stakeholders regarding these changes and the necessary tariff revisions on a schedule that could accommodate FTR implementation during the summer of 1999.

In these circumstances, the ISO had no alternative but to proceed with the development of other software changes on a platform that did not include the FTR proposal. Accordingly, on April 7, the ISO advised market participants that the implementation of FTRs would be postponed until after the summer. While the Commission largely approved the FTR proposal in the May 3 Order, software development work cannot now be re-directed to include the FTR program, as approved, without jeopardizing significantly the ISO's ability to implement Ancillary Services redesign and enable Y2K compliance of all systems.

The ISO now believes that the most appropriate schedule for implementing FTRs would be to hold an auction this winter for FTRs valid for the period extending from February 1, 2000 through March 31, 2001. A number of factors support this schedule.

First, the stakeholder process focused on the interrelationship between Existing Contracts, FTRs, and New Firm Uses is likely to be contentious and time-consuming. The earliest that the ISO could submit Tariff changes to the Commission would be early autumn. Even if the ISO were to request expedited consideration by the Commission, it is unlikely that software integrating these functions could successfully be completed before the end of the year. Because nothing must be allowed to jeopardize Y2K compliance, the ISO has imposed a moratorium on software changes for a six week period from December 1, 1999 through January 15, 2000.

Second, the records of Intra-Zonal congestion cost on Path 26 during the first 12 months of operation meet the first requirement for creation of a new Active Zone under the ISO Tariff.[11] The second requirement – the existence of workably competitive markets in the new Zones – will take time to evaluate. A new Zone would need approval of Market Participants, the PX, and the Commission, and would necessitate the development of new software. These processes cannot be completed until the end of the year. Obviously, the creation of a new Zone would affect the FTRs to be auctioned off. In fact, the ISO Tariff, as modified by Amendment No. 9 and approved by the Commission, prohibits the creation of a new Zone with an effective date during the period of outstanding FTRs. Thus, if the ISO determines a new Zone is necessary, implementation of the FTRs before the end of the year would postpone the creation of that new Zone for more than a year. This could have a significant impact on congestion markets and Intra-Zonal congestion costs.

Third, Market Participants will require lead time to adapt their own software and procedures to the new mechanisms for scheduling Existing Contracts and to a new Zone, if one is developed. Implementation before the end of the year would not provide that lead time.

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[11] Under section 7.2.7.2.1 of the ISO Tariff, the ISO may create a new Zone if the cost of alleviating congestion on a path is equivalent to at least 5 percent of the product of the rated capacity of the path and the weighted average Access Charge of the Participating TOs. If a workably competitive Generation market exists on both sides of the Inter-Zonal Interface for a substantial portion of the year, the Zone can be considered an Active Zone under sections 7.2.7.3.1 and 7.2.7.3.5 of the ISO Tariff.

Subsequent releases of one-year FTRs would be valid for periods extending from April 1 through March 31 of the following year. An April 1 release date would permit bidders to evaluate data on the potential for hydropower production during the upcoming season, a consideration that might inform the value they place on FTRs.

Consistently with the May 3 Order, the ISO would examine and report on its plans regarding longer-term FTRs, after it has been able to evaluate the performance of the FTR market during the first peak season. Among the factors to be considered will be the potential for the exercise of market power, whether through hoarding of FTRs or other means, and the impact of FTRs on the ISO's ability to manage congestion through market mechanisms. The ISO expects that the first peak season of experience with FTRs will provide it with data that will help it, and the Commission, to address these issues meaningfully.

The ISO therefore requests that the Commission adjust the deadlines set forth in the May 3 Order to permit the initial release of FTRs to be effective as of February 1, 2000. In order that the ISO may fully evaluate the experience of the first peak season during which FTRs are available, the ISO requests that the reports that the Commission directed it and the MSC to file be due on December 1, 2000, rather than October 1, 1999.[12]

[12] Although a twelve-month deferral to October 1, 2000, would be consistent with the delay in the initial release of FTRs, it would not allow sufficient time for analysis of data from the first summer's experience with FTRs.

III. The Commission Should Provide the ISO with the Guidance Requested

As described above, the ISO requested guidance on several matters, including: (1) whether the price caps applicable to the reassignment of point-to-point transmission service obtained under the *pro forma* tariff would apply with respect to secondary transactions in FTRs; (2) 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 that the FTR Holder is a public utility); and (3) the requirement that the transmission provider allow secondary sellers to post offers on its OASIS site. In order to expedite consideration of the ISO's proposal in time for the 1999 peak season, the Commission deferred consideration of these requests to a later order. May 3 Order, slip op. at 29. The resolution of these issues is necessary to minimize uncertainty regarding the secondary market for FTRs and thereby ensure that they trade at full value. Consumers will lose the benefit of congestion revenues if FTRs trade at a discount. In light of the need to defer implementation of the FTR program, the ISO requests that the Commission provide guidance on these issues at the earliest practicable time.

Conclusion

For the reasons outlined above, the ISO requests that the Commission (1) modify the May 3 Order to authorize the ISO to make the initial release of FTRs, equivalent to 100% of the 99.5% probable available capacity, on February 1,

2000; (2) defer the filing of the ISO's reports on its progress in developing a program for longer-term FTRs and on measuring available capacity, and of the MSC report on the FTR program, to December 1, 2000; and (3) provide the guidance requested in the ISO's filing of Amendment No. 9.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the forgoing document upon each person designated on the official service list compiled by the Secretary in this Docket No. ER98-3594-000 in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.2010 (1997).

Dated at Washington, D.C. on this 2nd day of June, 1999.

Michael E. Ward