

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**California Independent System Operator)
Corporation)**

Docket No. ER08-628

**MOTION OF THE CALIFORNIA INDEPENDENT
SYSTEM OPERATOR CORPORATION FOR LEAVE
TO FILE ANSWER, AND ANSWER TO PROTEST
AND COMMENTS**

Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure,¹ the California Independent System Operator Corporation (“CAISO”) hereby files this motion for leave to file an answer, and its answer to comments and protests filed in response to proposed modifications relating to a tariff amendment establishing charges for excessive declines of pre-dispatched bids for import or export energy, filed by the CAISO on February 29, 2008 (“Proposed Amendment”) in the above-referenced docket. Specifically, the CAISO responds to comments filed by Southern California Edison (“SCE”), Pacific Gas & Electric Co. (“PG&E”), Powerex Corp. (“Powerex”), Dynegy Power Marketing Inc. (“Dynegy”), various affiliates of Mirant Corp. (“Mirant”), and a joint protest from M-S-R Public Power Agency and the City of Santa Clara (“MSR/SVP”). To the extent that this answer involves an answer to protests, the CAISO requests leave to make this response. The CAISO believes that the additional information contained herein will assist the Commission’s deliberations with respect to these issues.

¹ 18 C.F.R. § 385.213 (2006).

I. BACKGROUND

A. The Proposed Amendment

The proposed tariff amendment addresses the consequences for Scheduling Coordinators who fail to deliver (*i.e.* “decline”) on bids to import or export real-time energy that the CAISO has accepted and dispatched. It establishes settlement charges that will be assessed to Scheduling Coordinators whose rate and absolute level of declines during a Trading Month exceeds an exemption threshold of 10% and 300 MWh, applied separately to imports and exports.

Determining the appropriate level for this exemption threshold was the most challenging issue in the stakeholder process. As detailed in the CAISO’s initial filing, the decision to propose 10% as the basic exemption threshold involved two factors. First, based on data about past declines, the CAISO believed that a percentage threshold of 5% could discourage too great a percentage of import energy. Second, the CAISO rejected as overly burdensome the alternative of exempting from the charge individual declines that were proven to be beyond the control of the Scheduling Coordinator. The 10% threshold includes all declines regardless of circumstances.

The alternative exemption of 300 MWh was intended to protect small volume marketers from being assessed a charge based on a small amount of declines due to circumstances beyond their control.

B. Comments and Protests

1. Parties that Participated in the CAISO Stakeholder Process Support the Amendment And Focus on the Precise Level of the Exemption Threshold

Five of the six commenting parties participated actively in the stakeholder process: Dynegy Power Marketing, Mirant, PG&E, Powerex, and SCE.

These parties support the amendment. SCE “[s]trongly [s]upports” it, stating “it is imperative that declined intertie bids be better addressed in the current and MRTU tariffs, because such declined bids create a whole host of problems.”² PG&E agrees that the amendment is necessary to close a “loophole” because “declined pre-dispatched bids have the potential to result in operational problems or market inefficiencies.”³ Likewise, Dynegy “general[ly] . . . supports the proposed amendments. Establishing clear thresholds regarding acceptable levels of declined intertie bids will benefit both the CAISO and its market participants.”⁴ Powerex concurs: “The CAISO has demonstrated the need for a settlement charge to discourage excessive declined pre-dispatched bids on the interties.”⁵

The comments from these parties are focused primarily on the level of the exemption threshold. Mirant, for example, though styling its pleading as a “protest” and contending that the proposal will “significantly decrease liquidity,”⁶ addresses only this issue. Mirant argues that the alternative exemption threshold of 300 MWh should be increased to 500 MWh.⁷ Consistent with the CAISO’s experience from the stakeholder

² SCE at 2.
³ PG&E at 3-4.
⁴ Dynegy at 3.
⁵ Powerex at 8.
⁶ Mirant at 3.
⁷ Mirant at 4-6.

process, the parties seem to fall in two camps. It seems that power marketers who bid at least in part based on resources owned by others support a higher threshold.⁸ On the other hand, the IOUs and other entities with large generation holdings prefer a lower one.

PG&E, SCE and Powerex represent the latter view. They do not oppose the idea of an exemption threshold, but they would lower the exemption threshold. PG&E and SCE advocate reducing the exemption threshold from the CAISO's 10% proposal to 5% by attempting to paint that as a compromise between the proposed 10% and their preference for an exemption only for declines shown to be outside the control of the Scheduling Coordinator.⁹

Powerex suggests the CAISO should bear some burden to establish any exemption threshold at all.¹⁰ Then, after stating a "theoretical . . . prefer[ence]" for a threshold of zero, Powerex concedes that this would be unworkable because "there may be legitimate instances where Scheduling Coordinators fail to deliver pre-dispatched bids because of circumstances outside of their control (*e.g.*, unexpected transmission or generation outages)," and that the CAISO may not have sufficient information or resources to judge whether a Scheduling Coordinator was actually unable to deliver.¹¹

Powerex criticizes the proposed 10% exemption threshold, advocating 5% instead, based on its argument that Scheduling Coordinators will in fact decline pre-

⁸ Comments submitted during the stakeholder process are available on the CAISO website: <http://www.caiso.com/1c72/1c72db9160800.html>. See the comments dated December 7, 2007 from Constellation Energy Commodities Group, Inc. and those dated December 5, 2007 from Coral Power, L.L.C.

⁹ *E.g.*, SCE at 2 (there should be "no exemption unless the party is able to demonstrate that the bids were declined as the result of a force majeure event. At most, SCE would advocate a 5% threshold."); *accord* PG&E at 5-7.

¹⁰ Powerex at 10.

¹¹ *Id.* at 11.

dispatches for solely economic reasons, and should be permitted to do so notwithstanding the anti-manipulation rules.¹²

The other camp is represented here by Dynegy, which supports the exemption as proposed.¹³ Dynegy's comments explain why some level of declines will necessarily occur, especially for power marketers that submit bids based on resources that they do not directly control. These power marketers will have some level of declines beyond that which can be attributed to unexpected transmission or generation outages because the CAISO uses different market timelines than Western bilateral markets:

[I]n the West, energy is traded during the half hour between the time a scheduling coordinator submits supplemental energy bids to the CAISO and the time the CAISO predispaches those bids. Predictably problems can and have occurred between the time bids must be submitted to the CAISO (75 minutes before the hour) and when the bids are "pre-dispatched" by the CAISO (45 minutes before the hour).¹⁴

2. Other Issues Addressed By Parties that Participated in the CAISO Stakeholder Process

Other comments focused on the relationship between the proposed amendment and section 37.3 of the CAISO tariff. Section 37.3.1.1 states:

Market Participants must bid and schedule Energy and Ancillary Services from resources that are reasonably expected to be available and capable of performing at the levels specified in the bid and/or schedule, and to remain available and capable of so performing based on all information that is known to the Market Participant or should have been known to the Market Participant at the time of bidding or scheduling.

SCE states its understanding that the "new rule must not be viewed as a 'free option to decline bids' as long as a party stays within the 10% threshold." Rather, it expects that

¹² Powerex at 9-10, 13-14.

¹³ Dynegy at 3 ("The CAISO has proposed reasonable thresholds before penalties will be applied . . .").

¹⁴ Dynegy at 3-4. The CAISO notes that in the current market, the bid deadline is 62 minutes before the hour.

section 37.3, “coupled with other anti-manipulation rules . . . prevent[s] participants from submitting energy bids for which they have no intent or reasonable capability of delivering.”¹⁵ SCE asks that the Commission “clarify that the language in Tariff section 37.3.1.1, as well as other anti-manipulation language, remains in full force even for transactions that fall below the approved threshold.”¹⁶

Dynegy seems to agree on this point,¹⁷ and proposes additional tariff language to ensure that, so long as a Scheduling Coordinator has violated only Section 37.3 and not other anti-manipulation rules, there will be no separate Sanction under section 37.3.¹⁸

Powerex disagrees, claiming that Scheduling Coordinators should be permitted to decline pre-dispatched bids for economic reasons.¹⁹

Finally, none of the commenting parties objects to the formula for calculating the proposed charges. PG&E, however, “encourages the CAISO to monitor the level of declined bids” and consider increasing the charges if the level of declines returns to the levels seen in the Spring of 2007.²⁰

3. Comments from Parties that did not Participate in the CAISO Stakeholder Process

Neither MSR or SVP submitted written comments during any of the four opportunities during the stakeholder process. Nor did they offer comments during any of the four calls.

¹⁵ SCE at 2-3.

¹⁶ SCE at 3.

¹⁷ Dynegy at 5 (“Dynegy does not dispute the CAISO’s assertion that failure to deliver energy from a pre-dispatched import or export bid might warrant scrutiny and sanction under another provision of the CAISO’s enforcement protocol, should that failure to deliver energy from a pre-dispatched import or export bid be part of some attempt to manipulate the CAISO’s markets.”)

¹⁸ *Id.* at 5-6.

¹⁹ Powerex at 15-16.

²⁰ PG&E at 5.

MSR and SVP ask the Commission to reject the CAISO’s proposal, contending that “the CAISO should consider paying a reservation fee or option premium if it has determined that declined bids have become so excessive as to warrant a solution.”²¹ The basic premise of their argument is that the proposed settlement charge for excessive declines “turn[s] a non-binding bid into a binding bid.”²²

The current CAISO pre-dispatch system . . . is very much like the physical bilateral market, in that bids are non-binding until the CAISO issues a pre-dispatch notice and the Scheduling Coordinator indicates that it intends to ‘accept.’ . . . The CAISO Proposal would, in effect, turn a non-binding bid into a binding bid, resulting in lost opportunity costs for the bidding entity.

They contend that it is the CAISO, not the suppliers, who would be obtaining the cost-free option.²³

MSR and SVP also claim that the proposed amendment will harm neighboring control areas.

[W]hile it may be true that declined pre-dispatches result in sub-optimal use of [re]sources for the CAISO, penalizing Scheduling Coordinators for declining a pre-dispatched bid would have the (likely unanticipated) effect of causing the same concern for the CAISO’s neighboring control areas. . . a non-binding bid should result in more instances where the least cost of serving load is achieved in the Western interconnect, and not just in the CAISO control area.²⁴

II. Discussion

A. Applicable Legal Standard

Under Section 205 of the Federal Power Act, it is the utility, not the Commission or the utility’s customers, that proposes a rate or an amendment to a rate. And it is the utility’s proposal, not alternatives proffered by others, that must be adjudged in the first

²¹ MSR/SVP ¶22; *accord id.* ¶ 16.

²² MSR/SVP ¶19.

²³ MSR/SVP ¶21.

²⁴ MSR/SVP ¶18.

instance. The Commission must determine whether the proposal is just, reasonable, and not unduly discriminatory. It need not be perfect or even the most “desirable”; it need only be reasonable.²⁵

Because it is the utility’s right to propose rates, the Commission cannot consider alternative rate proposals until and unless the Commission determines that the proposed rate is unjust, unreasonable, or unduly discriminatory.²⁶ The Commission’s authority to prescribe a rate arises from section 206 of the Federal Power Act, and under section 206, the Commission can only exercise that authority following a finding that the rates proposed are unjust, unreasonable, or unduly discriminatory.

B. The Exemption Threshold of 10% or 300 MWh is Just and Reasonable

As explained above, the CAISO’s burden is limited to showing that the proposed exemption threshold is reasonable; it need not show it is superior to all alternatives. The CAISO nevertheless believes it has made the best choice under the circumstances, and that the Commission should approve the threshold as proposed.

Contrary to the suggestion of some commenting parties, an exemption threshold of 5% is not a compromise middle ground among the viable positions, because a zero tolerance policy for declines is unworkable. Dynegy explains one of the reasons – the different market timelines between the CAISO and the rest of the West will lead to circumstances where declines are unavoidable for reasons other than force majeure. A significant portion of energy bids at the CAISO inter-ties are submitted by market

²⁵ See *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C.Cir. 1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to alternatives); *OXY USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C.Cir. 1995) (“[T]he Commission may approve the methodology proposed in the settlement agreement if it is ‘just and reasonable’; it need not be the only reasonable methodology or even the most accurate.”).

²⁶ See *Sierra Pacific Power Co. v. FPC*, 350 U.S. 348 (1956).

participants serving as energy marketers that do not directly control the resource to deliver on the bid once dispatched. The CAISO real-time energy market functions within the real-time bilateral market in the West, in which large portions of the transactions are finalized between the time participants submit bids to the CAISO and the time the CAISO dispatches energy at the inter-ties. Although participants should reasonably expect to be able to deliver on dispatched bids, requiring participants to enter into firm arrangements for energy that may not be dispatched by the CAISO has the potential to result in excessive costs as participants would have to contract for capacity that may not be used by the CAISO.

In addition, the CAISO should not be required to assume the burden of evaluating the circumstances of individual declines (assuming it would be permitted to make this evaluation itself, without Commission involvement). PG&E argues that the CAISO does not have to perform such an evaluation because Scheduling Coordinators can be expected to report honestly. The need for individual evaluation is not, however, mainly driven by a concern regarding dishonest behavior (although prudence recommends that the CAISO guard against this possibility as well), but rather the potential for differing interpretation and application of the “beyond a Scheduling Coordinator’s control” standard.²⁷ As Powerex explained in their comments submitted on October 10, 2007 as part of the stakeholder process²⁸ leading to this amendment, providing clear definitions of acceptable reasons for declines would be administratively complex and impractical:

²⁷ And PG&E concedes that the CAISO would need to “follow up with any Scheduling Coordinators who demonstrated a consistent pattern of declined bids.” PG&E at 6.

²⁸ Comments submitted during the stakeholder process are available on the CAISO website: <http://www.caiso.com/1c72/1c72db9160800.html>.

However, Powerex believes it can be very difficult to determine which declined dispatches should be excluded from UDP and which should not, for several reasons.

First, it may be difficult to formulate a transparent and easy to administer procedure that would categorize declined dispatches for exemption from UDP. For example, should a transmission curtailment in prior consecutive hours allow a participant to continue to submit bids without UDP consequences, based on an unrealistic expectation of that transmission being available? Should transmission curtailments that occur significantly before the close of the bid submission window enable a participant to claim exemption from UDP? Should a USF procedure that was initiated either prior to the bid submission window closing or was initiated in several previous consecutive hours, enable exemption from UDP? Does an implemented etag enable exemption from UDP, regardless of whether etags with similar transmission and/or generation has been curtailed hour after hour?

Second, the information necessary to qualify a UDP exemption would be difficult and time-consuming for the CAISO operational staff to compile. For example, it may require significant effort on the CAISO's part to examine all remaining transmission to verify that the transmission curtailments upstream or downstream of the CAISO indeed limited a participant's ability to supply, and whether such curtailments occurred before or after the bid submission window.

Faced with two realistic choices for the basic exemption threshold, 5% and 10%, the CAISO's choice of 10% is supported by the limited data. The fact is that no one knows exactly how the new rule will affect the decline rate for imports and exports. PG&E's point about the need for continued monitoring is well taken;²⁹ the CAISO Board of Governors gave this direction to staff. Until additional data and experience becomes available, however, the CAISO submits that its decision to err on the side of encouraging imports is the most reasonable choice.

The CAISO opposes Mirant's proposal to increase the absolute exemption from 300 MWh to 500 MWh in a month. First, the CAISO does not agree that Scheduling Coordinators "do not know the magnitude of their declines until the month is over" when

²⁹ PG&E at 4-5.

it is too late to alter their behavior.³⁰ Although it is certainly true that a Scheduling Coordinator would not know its total level of declines for a month until the end of that month, it would certainly be in a position to monitor its declines on an ongoing basis, and therefore, would know as the end of each month approaches where it stood in relation to the threshold. Second, the requested change is not supported by the example in Mirant's pleading. If a small Scheduling Coordinator submits 25 MWh bids at five inter-ties for each hour of the day with an assumed acceptance rate of even 10% of those bids, it would have 9,125 MWh of bids accepted during the month. Under the proposed amendment, its decline threshold would be 912 MWh without incurring charges. So the difference between 300 MWh and 500 MWh would not come into play.

C. The CAISO Accepts Dynegey's Suggested Modification to Section 37.3

The CAISO agrees with Dynegey's proposal to supplement the CAISO's proposed language in Section 37.3 with the phrase "but shall not be subject to any other Sanction under this 37.3" so that the MRTU version, for example, reads:

37.3.1.2 Consequences for Non-Performance

A Market Participant that fails to perform in accordance with the expected conduct described in Section 37.3.1.1 above shall be subject to having the payment rescinded for any portion of an Ancillary Service or RUC Capacity that is unavailable, or if the Market Participant fails to deliver on a HASP Intertie Schedule for import or export Energy, it shall be subject to any charge that may apply in Section 11.31, ***but shall not be subject to any other Sanction under this Section 37.3.***

This more clearly expresses the CAISO's intention and the preferences of the stakeholders.

³⁰ Mirant at 3.

D. The Commission Should Clarify that the Amendment does not Establish an Exemption to Anti-Manipulation Rules

The CAISO also agrees with SCE’s request that the Commission should affirm that Scheduling Coordinators remain subject to the full range of anti-manipulation rules based on abusive or fraudulent declines. In other words, although there will be no other penalty for violating section 37.3, market participants nevertheless remain subject to penalties under other rules or regulations based on the conduct that is contrary to section 37.3. This is a central assumption of the CAISO’s decision to set the exemption threshold at 10%.³¹

Powerex argues that the Commission should expect – and indeed, should permit – suppliers to decline pre-dispatches for solely economic consequences at a rate near the threshold exemption.³² The CAISO disagrees. The CAISO still expects Scheduling Coordinators to respond to dispatch instructions, and the tariff requirement is clear.³³ The purpose of the proposed amendment is not to give Scheduling Coordinators a free pass to decline pre-dispatches at whim, but rather to provide a safe harbor so that Scheduling Coordinators are not penalized for declines that occur due to circumstances beyond their control. Moreover, as noted above, the CAISO agrees that Scheduling Coordinators will remain subject to anti-manipulation rules if their declines evidence a pattern of abusive or fraudulent behavior. There is a world of difference between the

³¹ See CAISO Tariff Amendment at 8 n. 8.

³² Powerex at 15-16.

³³ E.g., MRTU Tariff 34.11.1 (“Resources must . . . unless otherwise stated in the Dispatch Instruction, comply with a Dispatch instruction immediately upon receipt . . . [and] respond to all Dispatch Instructions in accordance with Good Utility Practice”); MRTU Tariff 34.11.2 (“If a resource is unavailable or incapable of responding to a Dispatch Instruction . . . the resource shall be considered non-confirming to the Dispatch Instruction unless the resource has notified the CAISO of an event that prevents it from performing its obligations within thirty (30) minutes of the onset of such event through a SLIC log entry.”)

practices that the Commission permitted in the New York installed capacity markets, which were within the designated bid caps,³⁴ and the practice for which Powerex seeks the Commission’s blessing – *i.e.*, declining for solely economic reasons dispatches that Powerex acknowledges are binding under the CAISO tariff.

Consequently, the CAISO does not agree that this leaves “significant uncertainty for market participants.”³⁵ The true focus of Powerex’s complaint seems to be the anti-manipulation rules, rather than this amendment.

E. MSR and SVP Misunderstand the Underlying Rules

MSR and SVP’s protest is grounded in the assumption that bids currently are not binding in CAISO markets, and that the proposed amendment would represent a change. This is simply incorrect.³⁶ The proposed amendment represents a change to CAISO rules and expectations only insofar as it clarifies the consequences for Scheduling Coordinators who decline at excessive rates. MSR/SVP do not challenge this aspect of the amendment.

Nor is there any basis for MSR/SVP’s suggestion that the proposed amendment gives the CAISO a cost-free option on energy throughout the West. Resources outside the CAISO Control Area are not required to bid in CAISO-administered markets. They are free to decide whether to bid in light of the CAISO’s longstanding rule that bids are binding; they are not ensnared it. To the extent this requirement imposes additional costs on these resources, bidders can add “reservation premiums” to their bid. It would be

³⁴ Cf. Powerex at 16 n.39.

³⁵ Powerex at 15.

³⁶ See CAISO Tariff 37.3.1.1; MRTU Tariff 31.3.1.1 (“The Day-Ahead Schedules are binding commitments . . .”).

quite a different matter, though, and an obvious gaming opportunity, to require the CAISO to pay participants to merely submit bids, as suggested by MSR/SVP.

III. CONCLUSION

For the foregoing reasons, the CAISO respectfully urges the Commission to approve the Proposed Amendment with only those modifications discussed in Section II. C above, and reject the joint comments of MSR and SVP.

Respectfully submitted,

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Dated: April 16, 2008

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service list for the captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 16th day of April, 2008.

/s/ Susan L. Montana
Susan L. Montana