

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

Market-Based Rates for Wholesale Sales)
of Electric Energy, Capacity, and Ancillary) **Docket No. RM04-7-000**
Services by Public Utilities)

**COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION ON NOTICE OF PROPOSED RULEMAKING**

The California Independent System Operator Corporation (“CAISO”) hereby submits its comments in response to the Notice of Proposed Rulemaking (“NOPR”) concerning the Federal Energy Regulatory Commission’s regulations governing sales at market-based rates for public utilities issued on May 19, 2006 and noticed in the Federal Register on June 7, 2006 at 71 Fed. Reg. 33102. The Commission is proposing to modify and codify its standards for authorizing public utilities to make sales of electric energy, capacity, and ancillary services at market-based rates. The Commission states that this will help customers by ensuring that they are protected from the exercise of market power and provide greater certainty to sellers seeking market-based rate authority.¹

I. STATEMENT OF INTEREST

The CAISO is a non-profit public benefit corporation organized under the laws of the State of California with its principal place of business at 151 Blue Ravine Road, Folsom, CA 95630. The CAISO is the control area operator responsible for the operation of the electric grid comprising the transmission systems of a number of utilities, as well as the coordination of the ancillary services and wholesale electricity markets in California. The CAISO is a Commission-approved Independent System Operator (“ISO”).

¹ NOPR at P 7.

Since its inception, the CAISO has been concerned about the relationship between market-based rate authorization and the need to mitigate market power and maintain prices at just and reasonable levels. The Commission's proposal serves as an important foundation in determining whether entities have the ability to raise prices above competitive levels. While the NOPR addresses and seeks comment on many important issues regarding the criteria to be applied to individual applicants for market-based rate authority, the CAISO emphasizes that the dynamic nature of electricity markets and system conditions can bestow upon a participant significant market power even if the participant has passed the Commission's individual criteria for obtaining market-based rate authority. Given this, it is extremely important that the Commission: (1) focus on the conditions of the market itself, *i.e.*, whether the industry structure or market rules allow market participants (even those that have satisfied the Commission's market-based rate authorization criteria) to exercise harmful amounts of unilateral market power, and (2) ensure that adequate prospective market power mitigation procedures (particularly local market power mitigation procedures) are applicable to all participants in the RTO or ISO markets.

California has learned the hard lesson that close scrutiny with respect to initial grants of market-based rate authority is not enough, by itself, to protect consumers within the statutory mandates of the Federal Power Act. Initial authorizations must be combined with enforceable anti-fraud and anti-manipulation rules to ensure that suppliers do not create artificial conditions that can lead to unreasonable prices. In addition, appropriate mitigation measures must be contained in RTO and ISO tariffs to guarantee prices remain within statutory mandates.

The CAISO would like the opportunity to thank the Commission for addressing this significant topic. The CAISO will not be addressing every issue identified and discussed in the NOPR, just those of particular relevance and concern to California and the broader western energy market.

II. SUMMARY

The CAISO appreciates that the NOPR is intended to address authorization of suppliers to make sales at market-based rates under a variety of circumstances. This includes sales in areas with and without established RTOs and ISOs. The proposed rule, together with other Commission actions, including Order No. 670's prohibition of Energy Market Manipulation, are important factors in ensuring that wholesale electricity rates remain at just and reasonable levels.

The proposed rule also recognizes and relies upon the critical role that oversight by RTO and ISO market monitoring staff and strong and effective market power mitigation rules in RTO and ISO tariffs play in constraining market power. The CAISO agrees and highlights that the Commission's analysis must recognize the following:

1. Market-based rate criteria for individual applicants in an RTO or ISO must be combined with an analysis of the industry structure and rules governing operation of the electricity spot market and effective market power mitigation procedures tailored to these market characteristics to protect consumers. A periodic, snapshot analysis of a supplier's potential for exercising market power by itself is inherently imperfect and cannot fully capture how a supplier's ability to exercise market power changes under different system conditions. The dynamic nature of electric systems means that a geographic market can change quickly, and can bestow upon even relatively small

participants the ability to exercise market power over hours, days and even longer, with significant potential cost consequences to consumers. Given this, it is imperative that Market Base Rate authorizations for suppliers within an RTO or ISO be supplemented with: (1) an analysis of the characteristics of the spot markets administered by an RTO and ISO and (2) effective market power mitigation rules and procedures tailored to those market characteristics. Such an approach will better ensure that wholesale electricity markets that rely on competition to set prices also satisfy the Commission's mandate to protect consumers and maintain rates at just and reasonable levels.² In short, while the analyses proposed in the NOPR are important factors in determining whether or not an entity has market power, effective mitigation measures in RTO and ISO tariffs, particularly local market power mitigation provisions, are essential to maintaining rates within a zone of reasonableness.

2. The design of effective RTO/ISO market power mitigation rules would benefit from the Commission providing greater clarity on the extent to which the anti-fraud and anti-manipulation rules adopted in Order No. 670 address physical and economic withholding.

3. With regard to other specific aspects of the proposal, the CAISO:

- Supports consideration of its control area as a single market provided that the Commission approves strong and effective market power mitigation rules such as those contained in the CAISO Market Redesign and Technology Update filing;

² See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 US 591, 603 (1944).

- Requests that changes in status be reported to the applicable RTO/ISO market monitor as well as the Commission;
- Supports the continued ability of entities with market power in their home control area to sell at market-based rates outside their control area without restriction if the import capability into the home control area is competitive and potentially subject to market power mitigation or incentive programs, if the import capability into the home control area is non-competitive; and
- Supports the Commission's reliance on RTO and ISO market monitors to periodically assess competitiveness of ancillary service markets and market power mitigation provisions of RTO and ISO tariff to address potential for market power in ancillary service sales within their footprint.

III. COMMENTS

A. The Proposed Rule Appropriately Recognizes the Important Role that Market Power Mitigation Rules in RTO and ISO Tariffs Play in Restraining Market Power

In several instances in the proposed rule, the Commission recognizes the important roles that RTO and ISO market monitors and RTO and ISO tariff market power mitigation provisions play in ensuring that sales at market-based rates remain within just and reasonable levels. The CAISO agrees with this differentiation between sellers located within the footprint of an RTO or ISO and those that are not. Such an approach must be predicated, however, on the Commission approving strong and effective market power mitigation provisions in the RTO and ISO tariffs.

For example, as it relates to the determination of the applicable geographic market for purposes of the market power analysis, the Commission finds that if an entity is

within the jurisdiction of an RTO/ISO, “the added protections provided in structured markets with market monitoring, market power mitigation and transparency generally result in a market where attempts to exercise market power would be sufficiently mitigated.”³ The Commission also states that applicants can incorporate the mitigation they are subject to in RTO or ISO markets as part of their market power analysis.⁴ Thus, if a market power study showed that an applicant had market power, the applicant could point to RTO system-wide and local market power mitigation rules as evidence that this market power will be adequately mitigated.⁵

With regard to concerns about affiliate transactions, the Commission concludes that tying the price of an affiliate transaction to an established, relevant market price or index, such as in an RTO or ISO, is acceptable benchmark evidence and mitigates affiliate abuse concerns because the added protections in structured markets with central commitment and dispatch and market monitoring and mitigation generally result in a market where prices are transparent.⁶

With respect to sales of ancillary services at market-based rates, the Commission states that “[w]ith the formation of RTOs and ISOs, several RTO/ISOs performed market analyses to demonstrate whether various ancillary services are competitive” and “thus, in markets where the demonstration has been made, sellers are afforded the opportunity to sell at market-based rates subject to any other conditions in those markets.”⁷

The CAISO agrees that it is generally appropriate for the Commission to rely on the market power mitigation features of RTO and ISO tariffs in its consideration of

³ NOPR at P 59.

⁴ NOPR at P 60.

⁵ *Id.*

⁶ NOPR at P 113.

⁷ NOPR at n. 173.

whether or not to permit an entity to sell energy, capacity, or ancillary services at market-based rates. Nevertheless, there may be instances when these mitigation measures do not prevent a supplier from exercising a harmful level of unilateral market power. In this case, depending on the circumstances, other options to mitigate market power such as divestiture of supply resources, should be considered.

There is, however, a fundamental assumption underlying the reliance on RTO and ISO tariffs that must be emphasized – namely, RTO and ISO market mitigation and market monitoring procedures must be designed to reflect both the temporal nature of the spot markets (*i.e.*, the existence of hourly or shorter real time markets) and the dynamic nature of the electric system where it is known and anticipated that operational and weather conditions can occur that can bestow harmful levels of market power on participants. Market-based rate authority and mitigation provisions in RTO and ISO tariffs represent a type of pre-approval or pre-authorization process to engage in jurisdictional activities in the future in contrast to traditional cost-of-service ratemaking. These approvals must be tailored to address not only anticipatable and known effects that lead to the exercise of market power, but also those events that are not perfectly predictable as to precisely where and when they may occur.⁸

A periodic analysis of a supplier's potential for exercising market power is inherently imperfect. The dynamic nature of electric systems means that: (1) a geographic market can change quickly, and (2) it can bestow upon even relatively small participants the ability to exercise market power over several hours, days and longer (for example in the case of a severe drought where available hydro resources are drastically

⁸ Electric systems are designed to handle a variety of circumstances or contingencies - although it is impossible to know when they will happen.

reduced). In other words, changing system conditions (e.g., generating unit outages, transmission derates, changing load patterns, and loss of significant hydro capacity due to a drought) can potentially bestow any supplier with an ability to exercise market power at a given point in time (or for a given period of time). It is important that ISOs and RTOs have effective mitigation measures that would apply in the event of “unanticipated” transitory market conditions that would provide suppliers with the opportunity to exercise harmful levels of unilateral market power on a “temporary” basis. Also, it may be appropriate for ISOs and RTOs to have different mitigation measures depending on whether the “unanticipated” market or system condition will last for a short period of time or a prolonged period of time (e.g., drought conditions) and whether such “unanticipated” condition has a localized or a system impact. Additionally, the ISO and RTO market monitors and the Commission must be ready to respond quickly to protect consumers in the event that the market rules present unanticipated opportunities for the exercise of market power. As the Commission has recognized,

Wholesale market design flaws can present perverse incentives that may result in unintended inefficient or unreliable operations, but which may not be manifested for many months or years. It is critical that the MMU provide the ISO/RTO and the Commission with its perspective and expertise in the development of market rules and tariff provisions. It is also essential that the MMU work proactively in identifying market design flaws, and provide assistance to the ISO/RTO in developing appropriate rule changes that will promote reliable and efficient operation of the wholesale markets. While the Commission is responsible for ensuring just and reasonable rates, the Commission does benefit from the expertise of the ISO/RTO to provide the tariff filings to the Commission that help ensure that the market rules in place work effectively and to ensure that customers receive the full benefits of competitive wholesale markets. In response, the Commission makes every effort to act in a timely manner on such filings, and has recently announced procedures to assure expeditious Commission action when necessary to ensure smooth functioning of wholesale markets.⁹

⁹ Policy Statement on Mkt. Monitoring Units, 111 FERC ¶ 61,267 at P 4 (May 27, 2005).

The CAISO recognizes that to promote expeditious action, the Commission issued its Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators in April 2005.¹⁰ While this action is a significant improvement from the harm that could result from a traditional notice and comment period, the CAISO urges the Commission to revisit the suggestions of Commissioner Kelly expressed in that order to develop a process to grant temporary, concurrent relief in the nature of a temporary restraining order, which could be vital in preventing significant harm.

The Commission must recognize that the tests proposed in the NOPR are only an important first step in the overall process of utilizing market-based rates under the Federal Power Act. Market power can arise from unanticipated or changed conditions, market design flaws, or manipulative behavior. Procedures and processes need to be in place to protect against each of these possibilities in order to ensure just and reasonable outcomes.

B. The Commission Should Clarify the Interaction Between Its Rules on Prohibition of Market Manipulation and the Market-Based Rate NOPR

The California experience has shown that the assumptions that underpin the Commission's grant of market-based authority can be rendered inaccurate or obsolete if the supplier engages in a course of conduct that can create artificial conditions of scarcity, resulting in excessive prices. With regard to the interplay between the CAISO Tariff, the Commission's Order No. 670 on Prohibition of Market Manipulation, and the NOPR, the CAISO believes it would be important for the Commission to clarify the

¹⁰ 111 FERC ¶ 61,009 (2005).

extent to which economic and physical withholding of resources is prohibited conduct under Order No. 670.

In Amendment No. 55, the CAISO proposed to include, in its Enforcement Protocol, rules that prohibited Market Participants from engaging in physical withholding¹¹ or economic withholding.¹² The Commission rejected the proposal, stating *inter alia*:

[T]o the degree that physical and/or economic withholding occurs, we note that such behavior will be subject to investigation and enforcement by this Commission under the anti-manipulation provisions of Market Rule 2 of the MBR Tariff Order.¹³

In a later order on Amendment No. 55, the Commission stated “Market Behavior Rule 2 of the MBR Order has been tailored to address detrimental practices that could potentially lead to anomalous market conditions.”¹⁴

As adopted by the Commission, Market Behavior Rule 2 prohibited,

Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electric products.¹⁵

The purpose of the rule was to establish a prohibition that was broad enough in its reach to prohibit market abuses whose precise form and nature could not be envisioned but

¹¹ Physical withholding was defined as a failure to offer to sell or to schedule into the ISO Market the output of or services of a Generating Unit capable of serving an ISO Market, in a manner consistent with the ISO Tariff.

¹² Economic withholding was defined as (1) submitting a bid for a Generating Unit that is not consistent with the bid caps or thresholds specified in the ISO Tariff or (2) submitting a bid for a Generating Unit that is unjustifiably high relative to known operating characteristics and the known operating cost of the resource with the result that the Generating Unit is not dispatched or scheduled, and its bid (which is unjustifiably high) is not used and raises the price at which the market clears.

¹³ *Cal. Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,179 at P. 78 (2004); *see also* P. 100 (If physical and/or economic withholding occurs, such behavior will be captured under Market Rule 2 of the MBR Tariff Order.), *reh’g denied*, 107 FERC ¶ 61,118 at P. 35 (2004) (“Moreover, as the proposed language was drafted, the behavior addressed by EP 2.4 and 2.5 is covered by Market Rule 2 of the MBR Tariff Order”).

¹⁴ *Cal. Indep. Sys. Operator Corp.*, 107 FERC ¶ 61,118 at P. 43.

¹⁵ *Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 at P 35 (2003).

which would interfere with prices that would otherwise be set by competitive forces.¹⁶

The Commission found that physical withholding (defined as not offering available supply in order to raise the market clearing price) or economic withholding (defined as bidding available supply at a sufficiently high prices in excess of the supplier's marginal costs and opportunity costs so that it is not called on to run and where, as a result, the market clearing price is raised) could be a component of an activity that violated Market Behavior Rule 2.¹⁷

In January 2006, the Commission issued Order No. 670, Prohibition of Energy Market Manipulation. The order implemented the Energy Policy Act of 2005 by adopting a new Part 47 of the Commission's regulations making it unlawful for any entity to engage in fraudulent or deceptive conduct in connection with the purchase or sale of electric energy, natural gas, or transmission or transportation services subject to the jurisdiction of the Commission.¹⁸

In February 2006, the Commission rescinded Market Behavior Rule 2.¹⁹ The Commission found that such an action was appropriate to avoid regulatory uncertainty and confusion, to assure that all market participants are held to the same standard, and to provide clarity to entities subject to the Commissions rules and regulations.²⁰ The Commission noted that market power "can be used by a seller to manipulate markets; in

¹⁶ *Id.* at P 36.

¹⁷ *Id.* at P 102, n. 56, and n. 57; *order on reh'g*, 107 FERC ¶ 61, 175 (2004) at P. 27 ("In fact, where a seller intentionally withholds capacity for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products, it has done so without a legitimate business purpose in violation of Market Behavior Rule 2").

¹⁸ Prohibition of Energy Mkt. Manipulation, Order No. 670, 71 Fed. Reg. 4244 (Jan. 26, 2006); FERC Stats. & Regs. ¶ 31,202, 114 FERC ¶ 61,047 (January 19, 2006).

¹⁹ *Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations*, 114 FERC ¶ 61, 165 (2006), *order on reh'g*, 115 FERC ¶ 61,053 (2006).

²⁰ *Id.* at P 1.

such cases it is the act of manipulation – perpetrating a fraud or deceit of some kind-that is a violation of Rule 2 or the new anti-manipulation rule.”²¹

The CAISO asks the Commission to provide greater clarity on the deceptive conduct criteria it would use to determine whether a particular case of physical or economic withholding would be a violation of the new Part 47 regulations. For instance, under what conditions would physical withholding be considered perpetration of fraud or deceit? Would it be limited to cases where the seller provided false information regarding the status of the unit (e.g., reported equipment failures when in fact the unit was capable of operating) or does it cover a broader range of circumstances? Similarly, under what circumstances would economic withholding be considered a perpetration of fraud or deceit? Further clarification by the Commission on this will help ISO and RTO market monitors in developing effective market rules tailored for the types of physical and economic withholding that are not addressed under Part 47 regulations.

C. The Relevant Geographic Market

Under the NOPR, the default relevant geographic markets for the horizontal market power screens are first, the control area where the seller is physically located and second, the markets directly interconnected to the seller’s control area.²² If the seller is located in an area controlled by a regional transmission organization or independent system operator that operates as a single energy market with Commission-approved market monitoring and mitigation, the Commission proposes to designate the RTO or ISO in which the seller is located as the “default” relevant geographic market for

²¹ *Id.* at P 22.

²² NOPR at P 25.

purposes of market power analysis.²³ The Commission notes that on occasion some RTOs have been divided into smaller markets for study purposes because of frequently binding transmission constraints and asks “if the Commission determines that an RTO/ISO submarket is the appropriate default geographic region in a particular case and an applicant is found to have market power within that submarket, should the Commission consider mitigation in addition to existing RTO market monitoring and mitigation?”²⁴

The CAISO supports consideration of an RTO or ISO as a single market provided that the RTO or ISO is provided strong and effective market monitoring and market power mitigation rules. While undoubtedly sellers within certain submarkets of an RTO or ISO can be found to have market power under certain conditions (*e.g.*, frequently congested load pockets), denying such entities market-based rates would be a very blunt approach relative to mitigating such market power in a more targeted manner through effective prospective local market power mitigation rules. Effective local market power mitigation limits bid mitigation to circumstances where the ability of a seller to exercise substantial local market power has been identified. As discussed above, the ability of a seller to exercise substantial market power can be very dynamic and operational events can significantly affect the geographic scope of the market creating regions or more localized pockets of market power. The CAISO maintains that the best course is not to analyze each and every possibility in individual market-based rate applications – an all but impossible task - but to provide appropriate mitigation regimes in RTO and ISO tariffs.

²³ *Id.*

²⁴ NOPR at P 61 and P 62.

Indeed, the changes in ownership status discussed in the next section while important are only a part of the overall baseline for the initial market power analysis. Outages of generation or transmission facilities, load growth, and unusual weather conditions are some of the factors that can “reflect a departure from the characteristics relied upon in granting the market-based rate authority” yet these do not have to be reported. The only way to protect against these situations resulting in unexpected opportunities for market power is through thoughtful application of market power mitigation measures.

It is important to emphasize that any local market power mitigation mechanism cannot completely eliminate the exercise of market power. It can only limit the amount of market power exercised. Vigilance by the ISO and RTO market monitors and the Commission is required to determine: (1) if the level of local market power is unreasonable and (2) to protect against unintended consequences as suppliers factor the local market power mitigation mechanism into their profit-maximizing decision-making, often in ways unanticipated by the market designer.

D. Changes In Ownership Status

The Commission proposes in section 35.43 to require entities as a condition of obtaining and retaining market-based rate authority to report to the Commission in a timely manner any change in status that would reflect a departure from the characteristics relied upon in granting the market-based rate authority. These include: (1) changes in ownership or control that results in net increases of 100 MW or more and (2) changes in affiliation with any entity not previously identified.

The CAISO agrees with and supports the requirement that entities with market-based rate authority must report changes of status no later than 30 days after the change has occurred. Given the potential importance of these changes in status and given the importance the Commission has placed in the market monitoring function performed by RTOs and ISOs,²⁵ the CAISO proposes that any change in status be reported not only to the Commission, but also to the relevant market monitor where the facilities are located. This minimal additional burden on the supplier will ensure that RTO and ISO staff are operating with the latest possible information.

E. Sales Outside the Control Area

In the NOPR, the Commission asks whether it is appropriate to continue to allow sellers that are subject to mitigation in their home control area to sell power at market-based rates outside their control area and should the Commission adopt a form of "must offer" requirement in mitigated markets to ensure that available capacity (i.e., above that needed to serve firm and native load customers) is not withheld?²⁶

As to the first question, the CAISO believes that as long as the import capability into the home control area is competitive, it should not be possible for the seller to exercise market power in the home control area by scheduling its generation outside of the home control area and later offering it back to the home control area (as an import bid) at excessive prices. Such attempts would be thwarted by the competitive import bids

²⁵ As the Commission stated in its Policy Statement on Market Monitoring Units:

Good market rules are essential to efficient wholesale markets in which competing suppliers have incentives to meet the customers' needs for reliable service at the least cost. ISO/RTO markets are operationally complex. MMUs should have access to data and other resources to evaluate participant behavior and responses in these markets.

Policy Statement on Mkt. Monitoring Units, 111 FERC ¶ 61,267 at P 3 (May 27, 2005).

²⁶ NOPR at P 146.

of other suppliers. Similarly, if the seller attempted to withhold supply from the home control area by exporting some of its generation out, this behavior would be thwarted by the additional import capability the export schedules would create in terms of counter flows. Thus, so long as the import capability to the home control area is determined to be competitive, it does not appear that allowing sales at market based rates outside of the home control area would enable the seller to exercise market power within the control area.

However, it is important to emphasize that in most regional markets, a competitive supply of imports into a home control area for all hours may not exist. In such situations, market power mitigation mechanisms or other incentive schemes will be necessary to ensure that the local supplier makes all of its capacity available to supply energy and ancillary services to the home control area.

F. Ancillary Services

As noted above, in proposing to permit sales of ancillary services at market-based rates within the boundaries of an RTO or an ISO, the Commission proposes to rely on market analyses performed by RTO and ISO market monitors to demonstrate whether various ancillary services are competitive and the requirements and conditions of the RTO and ISO tariffs to ensure sales are at reasonable rates.²⁷ The CAISO agrees with this approach which again distinguishes between sales at market-based rates within an RTO or ISO and those not to an RTO or ISO. The CAISO agrees that the Commission

²⁷ NOPR at n. 173 (The result has been as follows: California Independent System Operator: Regulation, Spinning Reserve, and Non-Spinning Reserve. ISO New England: Regulation and Frequency (Automatic Generation Control), Operating Reserve – Ten-Minute Spinning, Operating Reserve – Ten-Minute Non-Spinning, and Operating Reserve – Thirty Minute. New York Independent System Operator: Regulation and Frequency Response Service, Operating Reserve Service (including Spinning Reserve, 10-Minute Non-Synchronized Reserves and 30-Minute Reserves). PJM Independent System Operator: Regulation and Frequency Response, Energy Imbalance, Operating Reserve – Spinning, and Operating Reserve – Supplemental).

can rely on the market monitoring unit of the RTO or ISO to assess competitiveness in its ancillary service markets. Again, the final rule must emphasize the importance of appropriate market power mitigation provisions- in this case for sales involving ancillary services being contained within the RTO or ISO tariff.

It is important to recognize several important aspects of the Ancillary service market. First the size of the market is subject to change based on system conditions and the need to meet applicable reliability criteria. At times, the CAISO may be able to procure ancillary services on a system-wide basis. At other times, factors such as the proportionate mix of hydro and thermal resources, transmission path operating transfer capability limits or deratings, forecasted path flows, anticipated load and weather conditions, and generator outages may require the CAISO to procure ancillary services on a more granular (zonal or even more location-specific) basis. Second, not every facility has the capability to provide every ancillary service. Thus, the market power analysis for the energy market does not automatically ensure that market power cannot be exercised with respect to sales of ancillary services. Accordingly, there may be the need for more targeted market power mitigation procedures specifically applicable to sales of ancillary services.

In essence, the NOPR appropriately recognizes that the Commission should exercise two types of scrutiny in evaluating authorizations to engage in sales of ancillary services. A heightened scrutiny when the supplier is not subject to monitoring and mitigation by virtue of its participation in an RTO or ISO market and a lesser level of scrutiny when the sales are under the oversight and potential mitigation measures of an RTO or ISO. This approach places responsibilities on the Commission and the RTO and

ISO to establish the necessary means: (1) to monitor the competitiveness of the ancillary service market on an ongoing basis, (2) to adjust the analysis, if necessary, to take into account locational procurement of ancillary services needed to comply with reliability criteria, and (3) identify and mitigate the potential exercise of unilateral market power in the ancillary service market to ensure prices remain within a zone of reasonableness.

IV. CONCLUSION

The CAISO thanks the Commission for the opportunity to participate in this proceeding and respectfully requests that the Commission consider these Comments as it proceeds in developing the rules on market-based rate authorizations.

Respectfully Submitted,

/s/ Anthony J. Ivancovich

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Dated: August 7, 2006



August 7, 2006

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

**Re: Market-Based Rates for Wholesale Sales of Electric Energy, Capacity, and
Ancillary Services by Public Utilities
Docket No. RM04-7-000**

Dear Secretary Salas:

Enclosed please find an electronic filing of the Comments of the California
Independent System Operator Corporation on Notice of Proposed Rulemaking.

Thank you for your attention to this filing.

Respectfully submitted,

/s/ Anthony J. Ivancovich
Anthony J. Ivancovich

Counsel for the California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

I hereby certify that I have, this 7th day of August 2006, caused to be served a copy of the foregoing document upon all the parties listed on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

/s/ Anthony J. Ivancovich
Anthony J Ivancovich