

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

**California Independent System) Docket No. ER06-615-000
Operator Corporation)**

**ANSWER TO REPLY COMMENTS OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Dated: June 2, 2006

TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY	2
ANSWER	6
I. The Commission Should Not Require Additional Technical Conferences or Other Procedures Prior to Issuing an Order on the MRTU Tariff Filing.....	6
A. The Issue of Whether Detail in the BPMs Should Be Added to the MRTU Tariff Should Be Addressed After the Commission Acts on the MRTU Tariff Filing and After a Stakeholder Process to Review the BPMs	6
B. The CAISO Is Developing a Process to Confirm the Readiness of the CAISO and Market Participants for MRTU Implementation	11
C. Delaying MRTU for Further State or Local Actions on Resource Adequacy is Unnecessary	14
II. The CAISO Responds To Certain Additional Arguments Raised in Reply Comments	16
A. Treatment of Balanced Self-Schedules	16
B. Ancillary Services	16
1. Self-provision of AS Using ETC rights.....	16
2. Exports of AS	18
3. Clarification Regarding Export Rules (Both Energy Exports and AS Exports) Under MRTU.....	19
C. Resource Adequacy	20
1. The Commission Should Approve the Resource Adequacy Provisions as a Vital Component of the CAISO Market Design and the CAISO’s Responsibilities as Control Area Operator	20
2. The Commission Should Approve the CAISO’s Proposed Minimum Reserve Criteria.....	24

3.	The Commission Should Approve the CAISO’s Proposal for Use-Limited Resources	27
4.	The CAISO Is Deferring to LRAs as to the Acceptable Level of Local Service Reliability Within Their Jurisdiction.....	29
5.	Resource Adequacy Resources Must Actually Be Made Available To the CAISO.....	32
6.	The MRTU Tariff Must Allow the CAISO To Continue Its Ability To Secure Backstop Resources To Meet Its Responsibilities for Reliable Grid Operations if an SC Fails To Provide Sufficient Resources To Meet Its Demand	34
7.	The CAISO Agrees All LRAs Should Be Informed of Resource Adequacy Resources Failing Compliance Tests.....	36
D.	Demand Response Under MRTU	36
1.	The CAISO Will Provide Release 1 Functionality for Participating Load	36
2.	The Specific Concerns Raised by Parties with Respect to the Treatment of Participating Load under MRTU Do Not Impact on the Justness and Reasonableness of the CAISO’s MRTU Proposal.....	39
3.	The CAISO Has Committed to Exploring Additional Opportunities for Demand Response Resources in MRTU After Release 1	41
E.	Marginal Losses.....	42
F.	Objective of the CAISO’s Optimization Methodology	44
CONCLUSION	45

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

California Independent System) Docket No. ER06-615-000
Operator Corporation)

**ANSWER TO REPLY COMMENTS OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

On February 9, 2006, the California Independent System Operator Corporation (“CAISO”)¹ filed its Market Redesign and Technology Upgrade Tariff (“MRTU Tariff”) for Commission review under Section 205 of the Federal Power Act (“FPA”), 16 U.S.C. § 824d (“February 9 Filing” or “MRTU Tariff Filing”). On or about April 10, 2006, a number of parties submitted initial comments, protests, and requests for hearings or other procedures concerning the February 9 Filing. Pursuant to the Commission’s March 7 and April 19, 2006, Notices of Extension of Time, the CAISO and a number of parties submitted reply comments concerning the MRTU Tariff Filing on or about May 16, 2006.² In some cases, these reply comments raise issues and arguments that the CAISO

¹ Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the MRTU Tariff or, to the extent these terms refer to the existing CAISO Tariff, have the meanings set forth in the Master Definitions Supplement, Appendix A to the currently effective CAISO Tariff.

² In addition to the CAISO, reply comments concerning the MRTU Tariff Filing were submitted by the following entities: Alliance for Retail Energy Markets (“AREM”); Bay Area Municipal Transmission Group² (“Bay Area”); Bonneville Power Administration (“BPA”); California Department of Water Resources and Sempra Generation (“CDWR/Sempra”); California Department of Water Resources State Water Project (“SWP”); California Electricity Oversight Board (“CEOB”); the California Municipal Utilities Association (“CMUA”); California Public Utilities Commission (“CPUC”); Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside California (“Six Cities”); City and County of San Francisco (“CCSF”); City of Redding, California, the City of Santa Clara, California and the M-S-R Public Power Agency (collectively, “Cities/M-S-R”); Cogeneration Association of California and the Energy Producers and Users Coalition (“CAC/EPUC”); Constellation Energy and Mirant (“Constellation/Mirant”); Electric Power Supply Association (“EPSA”); FPL Energy, LLC (“FPL”); Lassen Municipal Utility District (“Lassen”); Metropolitan Water District of Southern California (“MWD”); Modesto Irrigation District (“MID”); Northern California Power Agency (“NCPA”)’ Pacific Gas and Electric Company

already has addressed in its own May 16 reply comments (“CAISO Reply Comments” or “May 16 Reply Comments”). In other cases, the reply comments filed by other parties raise new issues and arguments that were not raised in previous comments or filings. In some reply comments, parties also request that the Commission establish technical conferences or other procedures to consider various elements of the MRTU Tariff Filing prior to issuing an order on that filing.

Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213, the CAISO hereby requests leave to file an Answer, and files its Answer to the reply comments and protests submitted in this proceeding on or about May 16, 2006.³

EXECUTIVE SUMMARY

As the CAISO has previously noted, there is substantial support among a wide range of stakeholders for the core elements of the MRTU design. This support is reflected in a number of the reply comments. For example, Constellation/Mirant:

reiterates its belief that the as-filed MRTU design fundamentally achieves the primary objectives of MRTU to: “(1) perform effective Congestion Management in the CAISO forward markets (Day-Ahead) by enforcing all

(“PG&E”); Powerex Corporation (“Powerex”); Sacramento Municipal Utility District (“SMUD”); San Diego Gas & Electric Company (“SDG&E”); Southern California Edison Company (“SCE”); Transmission Agency of Northern California (“TANC”); and Williams Power Company (“Williams”). PacifiCorp also filed a Motion to Intervene Out-of-Time and Protest on May 16

³ There is no prohibition on answers to reply comments. *See* Rule 213(a)(3), 18 C.F.R. § 385.213(a)(3) (permitting an answer without permission of the decisional authority to any pleading other than a protest, a motion for oral argument, or a request for rehearing). Rule 213 permits answers to pleadings other than motions not later than 30 days after the filing of the pleading, unless otherwise ordered. 18 C.F.R. § 385.213(d)(2)(ii). Certain reply comments are also captioned as “protests.” The CAISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2) to permit it to respond to protests in this filing. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case. *See, e.g., Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Company*, 93 FERC ¶ 61,098, at 61,259 (2000).

transmission constraints so as to establish feasible forward schedules; (2) create a Day-Ahead Market for energy; (3) automate Real-Time Dispatch so as to balance the system and manage Congestion in an optimal manner with minimal need for manual intervention; and (4) ensure consistency across market time frames (Day-Ahead through Real-Time) in the allocation of the transmission resources to grid users and in the pricing of transmission service and Energy.”

Constellation/Mirant Reply Comments at 1-2, quoting the MRTU Tariff Filing Letter at 2. Other commenters express similar support for the core elements of the MRTU Tariff.⁴

Unsurprisingly, however, many comments on the MRTU Tariff, both initial and reply, do not highlight the elements of the MRTU design that have substantial support but instead focus on those provisions of the MRTU Tariff that commenters would like to see modified. Although the CAISO does not believe most of the proposed modifications are justified, the CAISO acknowledged in its May 16 Reply Comments that certain comments raised valid concerns that justify revisions to the MRTU Tariff. The CAISO therefore committed to make a number of targeted revisions and clarifications to the MRTU Tariff to address these valid concerns.

In the instant Answer, the CAISO commits to make the following additional clarifications to the MRTU Tariff in response to questions or concerns raised in reply comments:

- revisions to the resource adequacy provisions of the MRTU Tariff to clarify that the CAISO will defer to the applicable Local Regulatory Authority (“LRA”) as to the acceptable level of service reliability within the LRA’s jurisdiction to the extent consistent with meeting Applicable Reliability Criteria; and

⁴ See also PG&E Reply Comments at 1 (“PG&E continues to support the CAISO’s efforts to implement the core MRTU program outlined in the Proposed MRTU Tariff in an expeditious, disciplined fashion.”); SDG&E Reply Comments at 6-7 (“By deciding that it has a sufficient record to rule on the MRTU Release 1 controversies without further delay, the Commission can reject those stakeholder comments calculated to produce regulatory paralysis.”); CEGB Reply Comments at 2 (“The CEGB believes that the MRTU Tariff filing is a commendable effort to improve the wholesale electricity market in California.”).

- revisions to clarify that the CAISO will report a Resource Adequacy Resource's failure to pass a compliance test to the applicable LRA and not just to the CPUC.

These MRTU Tariff modifications represent clarifications rather than a change of existing policy and are entirely consistent with the MRTU design. Section II of this Answer explains why other modifications to the MRTU Tariff proposed in certain reply comments are not justified.

For the reasons explained in its May 16 Reply Comments, the CAISO continues to believe that a Commission order on the MRTU Tariff Filing as soon as reasonably practicable is important.⁵ In both initial and reply comments, various commenters propose technical conferences, hearings, or other procedures on a range of MRTU-related issues. The extensive record before the Commission in this proceeding is sufficiently well-developed to permit the Commission to act on the MRTU Tariff Filing without technical conferences, hearings, or additional procedures.⁶ In its May 16 Reply Comments, the CAISO did propose technical conferences on two issues: (1) the question of whether certain details in the Business Practice Manuals (“BPMs”) being developed by the CAISO and reviewed in a stakeholder process this summer should be moved to the MRTU Tariff and (2) the development of an equitable methodology for allocating Resource Adequacy import capacity. Because these technical conferences would address issues that will be the subject of subsequent filings, and these filings will not alter the core elements of the MRTU Tariff, the proposed conferences need not and should not delay a Commission order on the MRTU Tariff Filing.

In its May 16 Reply Comments, the CAISO also explained that issues involving the details of MRTU implementation or other issues that, while important, are peripheral

⁵ CAISO Reply Comments at 55-56.

⁶ See CAISO Reply Comments at 20-25, 46-49.

to the core elements of the MRTU design will be addressed through the CAISO's ongoing MRTU stakeholder process. For example, the CAISO's stakeholder process will address the CAISO's commitment to develop readiness criteria to ascertain CAISO and Market Participant readiness to move to the new markets. As explained below, the stakeholder process to address these issues is already underway. The issues to be addressed through the MRTU stakeholder process are important but will not alter the core elements of the MRTU design as reflected in the MRTU Tariff Filing.

As noted above, many reply comments filed by other parties simply re-state arguments the CAISO has already responded to in the CAISO's May 16 Reply Comments. The CAISO will not repeat those responses here.

For all the reasons stated in the MRTU Tariff Filing, in the CAISO's May 16 Reply Comments, and in the Answer below, the Commission should find that the terms and conditions of the MRTU Tariff are just and reasonable and that the record concerning the MRTU Tariff is sufficiently developed that the Commission can approve the MRTU Tariff Filing without hearings or additional procedures prior to a Commission order. The Commission should reject comments seeking substantial alterations to the MRTU Tariff and accept the MRTU Tariff with only those clarifications and revisions the CAISO committed to make in its May 16 Reply Comments and commits to make in the instant Answer.

ANSWER

- I. The Commission Should Not Require Additional Technical Conferences or Other Procedures Prior to Issuing an Order on the MRTU Tariff Filing**
- A. The Issue of Whether Detail in the BPMs Should Be Added to the MRTU Tariff Should Be Addressed After the Commission Acts on the MRTU Tariff Filing and After a Stakeholder Process to Review the BPMs**

In both initial and reply comments, a number of parties have raised concerns about the Business Practice Manuals the CAISO is developing to provide implementation detail and procedures that will assist the CAISO and Market Participants in applying and complying with the rates, terms and conditions of the MRTU Tariff. Comments on the BPMs generally fall into two camps – those who argue that the entire BPMs should be filed as part of the MRTU Tariff for Commission approval under Section 205 of the Federal Power Act (“FPA”)⁷ and those who do not seek the filing of the full BPMs but contend that certain details slated for inclusion in the BPMs should be incorporated into the MRTU Tariff.⁸

As the CAISO explained at length in its May 16 Reply Comments, long-standing Commission policy is quite clear that BPMs, like the business practice manuals and procedures of other Independent System operators (“ISOs”) and Regional Transmission Organizations (“RTOs”), do not need to be filed for Commission approval.⁹ The Commission recently reaffirmed this policy in its Notice of Proposed Rulemaking concerning the reform of the *pro forma* Open Access Transmission Tariff¹⁰:

⁷ See TANC Reply Comments at 6-7; CEOB Reply Comments at 4.

⁸ See SDG&E Reply Comments at 6; PG&E Reply Comments at 14-15.

⁹ CAISO Reply Comments at 16-20.

¹⁰ *Notice of Proposed Rulemaking, Preventing Undue Discrimination and Preference in Transmission Service*, 115 FERC ¶ 61,211 (2006) (“OATT Reform NOPR”).

Commenters presented wide ranging positions on the issue of what rules, standards and practices to include in the OATT. We do not propose to modify our existing policy on this issue at this time. We agree with EPSA's concern that requiring transmission providers to include all of their rules, standards and practices in their OATTs could decrease a transmission provider's flexibility to change businesses [sic] practices and respond to the requests of customers. Additionally, we believe that requiring transmission providers to file all of their rules, standards and practices in their OATTs would be impractical and potentially administratively burdensome.

OATT Reform NOPR at P 452 (footnotes omitted). The Commission's general concerns are particularly apt in the present case. Filing the thirteen MRTU BPMs under development would not only be impractical and burdensome, it would also hinder the implementation of MRTU because it would limit the CAISO's ability to modify its business practices and procedures in response to experience with the new market design and to address stakeholder concerns.

TANC is incorrect when it claims that the Commission's recent order in Docket No. ER06-700 requiring the CAISO to file its Credit Policy and Procedures Guide ("CPPG") supports the conclusion that all BPMs must be filed with the Commission.¹¹ First, that order recognized that portions of the CPPG may not need to be on file with the Commission. The Commission expressly provided an opportunity for the CAISO to explain which portions of the CPPG it does not believe should be included in the CAISO Tariff.¹² Moreover, the OATT Reform NOPR strongly suggests that the Commission views creditworthiness requirements as *an exception* to the general rule that certain details related to a transmission provider's tariff need not be on file with the Commission,

¹¹ *California Independent System Operator Corp.*, 115 FERC ¶ 61,170 (2006).

¹² *Id* at P 22.

and even there, the Commission stated that the creditworthiness provisions of a tariff can be “supplemented with a credit guide or manual to be posted on OASIS.”¹³

Although the full BPMs need not and should not be filed for Commission approval, the question remains whether any details slated for inclusion in the BPMs should be incorporated into the MRTU Tariff to satisfy the Commission’s “rule of reason.” Consistent with Commission precedent applying the rule of reason, the CAISO agrees that all matters directly affecting rates, terms and conditions of service must be included in the MRTU Tariff, and acknowledges that some details being developed for inclusion in the BPMs might fall into this category. The CAISO also recognizes that there is significant stakeholder concern as to whether details in the BPMs should be in the MRTU Tariff. The CAISO has therefore proposed a process that would allow for stakeholders to raise these concerns with the CAISO, Commission staff, and ultimately the Commission itself but that would not require a delay in the Commission’s order on the MRTU Tariff Filing.

Specifically, the CAISO urges stakeholders to raise concerns about specific provisions during the BPM development stakeholder process. In the May 16 Reply Comments, the CAISO also recommended that the Commission convene a technical conference later this year to review any unresolved issues regarding the proper detail of the tariff and the BPMs. Following this stakeholder input and technical conference, the CAISO can make a Section 205 filing to move appropriate material into the MRTU Tariff.

The reply comments of PG&E, CEOB, CMUA and others continue to raise concerns about the level of detail in BPMs. In response, the CAISO offers more detail on

¹³ OATT Reform NOPR at PP 453-55.

its proposal for addressing these concerns. The CAISO has already published initial drafts of the following BPMs, consisting of over 800 pages of details, examples and business rules building on the terms and conditions of the MRTU Tariff: Market Instruments, Market Operations, Settlements & Billing, and Definitions & Acronyms. Six days of stakeholder meetings to discuss these drafts were held in May. The CAISO intends to post drafts of all thirteen BPMs by July 31, to be followed by several weeks of stakeholder review meetings starting in mid-August. To facilitate stakeholder review, these BPMs will identify the relevant implementing authority in the MRTU Tariff. For example, every charge type listed in the settlements BPM will be linked to a Tariff provision authorizing the charge. The CAISO urges all stakeholders to identify during the BPM review meetings any specific details in the BPMs that they believe should be incorporated into the MRTU Tariff under the Commission's rule of reason.

Based on that stakeholder input, the CAISO will develop a straw proposal as to which detail the CAISO believes should be moved from the BPMs to the MRTU Tariff. This straw proposal can then be discussed during a technical conference that the CAISO recommends that the Commission convene in late September to be held in San Francisco. During this conference, the CAISO can address questions from stakeholders and Commission staff as to why certain portions of the BPM should or should not be moved to the MRTU Tariff. The CAISO believes the Commission and stakeholders will benefit from a discussion of such issues at a BPM technical conference following this summer's BPM stakeholder process. After this BPM technical conference, the CAISO will develop a filing to move appropriate portions of the BPMs to the MRTU Tariff. This filing will be submitted for Commission review (and public comment) pursuant to Section 205 of

the FPA. The CAISO expects that the stakeholder process and technical conference will narrow the range of issues that the Commission will have to address in response to this filing. For this reason, the CAISO believes that the Commission's order on the MRTU Tariff Filing should not address questions of whether specific details slated for inclusion in the BPMs should be moved to the MRTU Tariff. Instead, the CAISO urges the Commission to accept the MRTU Tariff conditioned upon the completion of the BPM review process described in this filing and submission of a filing to move appropriate portions of the BPMs to the MRTU Tariff.

The CAISO believes this approach – stakeholder meetings followed by a technical conference and a Section 205 filing moving specific portions of the BPMs to the MRTU Tariff – will be the most efficient way of resolving concerns about the level of detail in the MRTU Tariff. The CAISO urges the Commission to recognize that the process the Commission has established for considering what details in the CAISO's Credit Policy and Procedures Guide should be included in the CAISO Tariff would be burdensome and impractical for the BPMs. The CPPG is 32 pages, while the full text of the thirteen BPMs plus appendices will comprise several thousand pages. Requiring the CAISO to file the entire BPMs and then litigate what provisions should or should not be in the Tariff on a section-by-section basis will be tremendously onerous for Commission staff, stakeholders and the CAISO, wasting scarce resources of all involved that could better be utilized to move forward with the new markets in California. On the other hand, the approach proposed by the CAISO is designed to narrow disputes through dialogue with stakeholders, promoting consensus and, to the extent full consensus is not attained,

allowing the Commission to focus on only the remaining significant differences in opinion regarding the need to move details from the BPMs to the MRTU Tariff.

Moreover, consistent with the Commission's order in *Midwest Independent Transmission System Operator*¹⁴, the process of evaluating whether additional detail from the BPMs should be added to the MRTU Tariff need not delay a comprehensive order on the MRTU Tariff as filed with the Commission. In the *Midwest ISO* order, the Commission upheld its order conditionally accepting the Midwest ISO's Transmission and Energy Markets Tariff notwithstanding the Commission's finding that additional detail slated for inclusion in the Midwest ISO's business practice manuals should be added to the Midwest ISO Tariff.¹⁵

B. The CAISO Is Developing a Process to Confirm the Readiness of the CAISO and Market Participants for MRTU Implementation

Various parties express concerns in both their initial and reply comments as to whether the CAISO's software and systems, as well as the systems of Market Participants, will be fully tested and ready for the proposed November 2007 MRTU implementation date. In its May 16 Reply Comments, the CAISO agreed that it is appropriate to develop a process that will allow both the CAISO and Market Participants to show their readiness to move to the new markets prior to implementing MRTU.¹⁶ The CAISO committed to develop specific criteria for MRTU readiness through a collaborative process with active stakeholder participation. The CAISO further committed to report on the development of both the CAISO and Market Participant readiness criteria in its monthly MRTU status reports to the Commission and to file a

¹⁴ 109 FERC ¶ 61,157 (2004).

¹⁵ *Id.* at PP 557-564.

¹⁶ CAISO Reply Comments at 52-54.

statement confirming the CAISO's determination that the CAISO readiness criteria have been satisfied with the Commission for informational purposes at least 30 days prior to MRTU implementation.

SCE and PG&E argue that the MRTU readiness criteria should be submitted to the Commission in a compliance filing which is presumably subject to Commission approval.¹⁷ The CPUC contends that, prior to MRTU start-up, the Commission should rule on "whether the CAISO's and other market participants' systems are sufficiently functional to go live."¹⁸ There is no justification for requiring Commission approval of either the MRTU readiness criteria or the CAISO's readiness determination. Other ISOs moving from wholesale market designs not based on Locational Marginal Pricing to LMP-based markets have not been required to obtain Commission approval of readiness before implementing the new market design. For example, the Commission only required ISO-New England and the New England Power Pool to provide written notice to the Commission "that Market Rule 1 and its associated software are in place" two weeks in advance of the effective date of the New England LMP-based Standard Market Design.¹⁹

Filing a statement of the CAISO's readiness evaluation on an informational basis will provide the Commission and interested parties with sufficient data to assess the CAISO's determination that the new markets are ready for implementation. In the unlikely event that the Commission has any concerns about the CAISO's determination, the Commission, the CPUC and other parties can and should expect that the CAISO will take seriously any Commission concerns about the readiness of the markets either before

¹⁷ See SCE Reply Comments at 2-3.

¹⁸ CPUC Reply Comments at 15.

¹⁹ *New England Power Pool, et al.*, 100 FERC ¶ 61,287 at P 21, Ordering Paragraph E (2002).

or after that informational filing. Of course, the Commission will also have the authority to act at any time under Section 206 of the FPA if it believes readiness concerns would prevent the implementation of just and reasonable markets.

As noted above, the CAISO has already initiated an effort to accelerate MRTU readiness planning and execution. The CAISO has developed an MRTU readiness proposal designed to establish a comprehensive approach to identify and measure the CAISO's preparedness to perform all functions necessary to support MRTU implementation as well as the preparedness of Scheduling Coordinators and possibly other Market Participants. This proposed readiness approach will be discussed with stakeholders at the June 20, 2006 MRTU implementation workshop.²⁰ Commission staff are invited to attend and participate in this workshop. Following finalization of the readiness approach, the CAISO intends to establish measurable readiness criteria on a collaborative basis with stakeholders, to identify mitigation actions for non-performance or failure to meet readiness criteria, to establish a methodology for determining whether the CAISO and Scheduling Coordinators or other Market Participants are prepared for MRTU implementation, and to develop an MRTU readiness tracking system tied to specific milestones within the MRTU program timeline. The CAISO believes that this approach, to be developed and refined through the MRTU stakeholder process, will address any commenter concerns with MRTU readiness.

On a related note, the CPUC expresses a concern that delays in the release of specifications for Automated Program Interface Documentation could prevent Market Participants from developing the systems to be ready for a November 2007 MRTU

²⁰ The agenda for this workshop is posted on the CAISO Website at: <http://www.caiso.com/1807/1807880d424e0.pdf>

implementation date.²¹ The CAISO notes that it posted technical interface documentation for MRTU Bidding, Market Results, Settlements, ADS, and OASIS systems on the CAISO Website on May 31, 2006.²² The CAISO expects that this posting, as supplemented with revised and additional MRTU technical interface documentation, will provide Market Participants with sufficient time to be ready for MRTU implementation in November 2007

The CPUC also supports the public release of the Full Network Model.²³ The CAISO is undertaking a legal review to determine what details of the Full Network Model can be released without violating restrictions on the release of proprietary information or running afoul of confidentiality concerns. The CAISO intends to update stakeholders on the release of the Full Network Model at the June 20 MRTU implementation workshop. The CAISO urges the Commission to refrain from issuing any directive in this regard.

C. Delaying MRTU for Further State or Local Actions on Resource Adequacy is Unnecessary

CCSF argues that resource adequacy programs under development by state and local authorities should be “complete” before a new market design is implemented.²⁴ The CAISO strongly disagrees. Although State and local authorities will continue to fine-tune their respective resource adequacy programs, the basic elements of the California Resource Adequacy program are in place. There must be a forecast of Demand, resources must be secured either by construction or by contract to meet that forecast, those resources must reasonably perform and be deliverable to the grid, and the resources

²¹ CPUC Reply Comments at 12.

²² This documentation can be found at: <http://www.caiso.com/17ba/17baa96f22110.html>.

²³ CPUC Reply Comments at 9-10.

²⁴ CCSF Reply Comments at 3.

must be available for dispatch to serve Load. With implementation of Assembly Bill 380 (“AB 380”), California authorities have recognized the basic parameters of a resource adequacy program. There is no need for further staging of resource adequacy, beyond that accomplished by the Interim Reliability Requirements Program (“IRRP”), and no reason for delay in either implementation of the MRTU Tariff requirements or Commission action on the resource adequacy provisions of the MRTU Tariff.²⁵ To the contrary, the CAISO believes it is far preferable that Market Participants be given greater certainty concerning their respective resource adequacy obligations at the earliest possible time to facilitate the necessary procurement to support grid and market operations.²⁶

For the same reason, the CAISO opposes technical conferences or further procedures on the resource adequacy provisions of the MRTU Tariff. The CAISO does agree, however, that further discussion would be beneficial on the specific issue of allocation of intertie capacity. For that reason, the CAISO supports a technical conference to develop an equitable methodology for allocating resource adequacy import capacity. This methodology will not apply until 2008 and beyond,²⁷ and is not a core element of the MRTU design that is expected to impact the development of MRTU software. As such, the Commission need not commence this technical conference until later this year, after the Commission has issued an order on the MRTU Tariff Filing.

²⁵ See *California Independent System Operator Corp.*, 115 FERC ¶ 61,172 (2006) (“IRRP Order”)

²⁶ The CAISO addresses a number of substantive issues involving the resource adequacy provisions of the MRTU Tariff in Section II.D of this Answer.

²⁷ See IRRP Order, 115 FERC ¶ 61,172 at PP 94, 96.

II. The CAISO Responds To Certain Additional Arguments Raised in Reply Comments

A. Treatment of Balanced Self-Schedules

Several commenters reiterate their concern with the Integrated Forward Market (“IFM”) scheduling priorities contained in Section 31.4(a)-(g) of the MRTU Tariff.²⁸ In its May 16 Reply Comments, the CAISO: (i) acknowledged that the concern raised by SCE, the CPUC and others could arise in situations of supply shortage in the IFM, and (ii) proposed a solution.²⁹ The CAISO has reviewed the reply comments filed on this issue and believes its proposed solution fully addresses the concerns of these commenters.

B. Ancillary Services

1. Self-provision of AS Using ETC rights

Six Cities, in responding to comments by SCE regarding self-provision of Ancillary Services (“AS”), state that any restrictions on the self-provision of AS must be applied on a comparable basis.³⁰ The CAISO agrees with Six Cities’ comment. The proposed rules, including limitations, in the MRTU Tariff regarding self-provision of AS are non-discriminatory.

²⁸ See, e.g., SCE Reply Comments at 18-20; CPUC Reply Comments at 13-15; Six Cities Reply Comments at 17; and NCPA Reply Comments at 2-4.

²⁹ See CAISO Reply Comments at 119-125. The CAISO’s proposed solution is two-fold. First, as suggested by SCE and others, the CAISO will provide self-scheduled internal Demand in the IFM with a higher priority than self-scheduled exports not matched by resources. See CAISO Reply Comments at 122, 124. Second, the CAISO proposes that self-scheduled export Demand served by non-Resource Adequacy and non-RUC capacity will have a priority equal to internal self-scheduled Demand in the IFM and the CAISO demand forecast in the Hour-Ahead Scheduling Process (“HASP”). *Id.* at 123, 124. The proposed solution is reasonable and balanced; it addresses the concerns raised between Demand internal to the CAISO Control Area regarding self-scheduled exports not matched by resources. At the same time, the solution also provides entities serving Demand in other Control Areas (*i.e.*, self-scheduled exports) with the same scheduling priority as internal Demand in both the IFM and the HASP so long as such entities self-schedule exports of Energy from non-RA, non-RUC generating capacity.

³⁰ Six Cities Reply Comments at 8. The CAISO previously responded to SCE’s comments regarding over self-provision of AS. See CAISO Reply Comments at 159-162.

The main limitation on self-provision of AS under MRTU is the initial limitation on the self-provision of imported AS from outside the CAISO Control Area.³¹ The CAISO notes that its comments on this issue did not indicate how the initial limitation on self-provision of AS from outside the CAISO Control Area applies to ETC rightsholders and provides the following brief clarification. It is axiomatic that the rights of each ETC rightsholder are defined by the contract. Therefore, if a contract does not involve transmission service over an intertie and/or if the contract does not allow the rightsholder to self-provide AS, then the limitation on self-provision of AS from outside the CAISO Control Area will apply to an ETC rightsholder (as it would to a non-ETC rightsholder). If on the other hand, the contract does involve transmission service or import capacity over an intertie and if the contract allows the rightsholder to self-provide AS, then the CAISO will allow the ETC rightsholder to self-provide AS over the intertie using its ETC rights. However, if an ETC allows for self-provision of AS over an intertie, the ETC rightsholder will have to comply with the applicable provisions of the MRTU Tariff regarding self-provision of AS (*e.g.*, the CAISO must receive a Submission to Self Provide an Ancillary Service from the ETC rightsholder and the AS capacity must be able to be dispatched by the CAISO if needed), and the CAISO will have to implement this functionality manually. The CAISO notes that there has been almost no self-provision of AS using ETC rights under the existing CAISO Tariff and, therefore, the issue of self-provision of AS imports using ETC rights may be limited in scope (*i.e.*, the lack of self-provision of AS may indicate that many of the ETCs either don't involve

³¹ See CAISO Reply Comments at 145-147 (discussing reason for initial limitation on self-provision of AS from outside CAISO Control Area).

transmission service over an intertie or don't contain provisions allowing the rightsholder to self-provide AS).

2. Exports of AS

Both SCE and Six Cities oppose the suggestion by WPTF/IEP that the CAISO should allow entities serving load in other Control Areas to be able to bid to buy AS from the CAISO markets.³² SCE states that no other Control Area in the Western Electricity Coordinating Council ("WECC") has organized AS markets and that arguing that the CAISO is somehow obligated to sell AS to other Control Areas is "nonsensical."³³ Six Cities argue that such a modification could undermine the reliability of the CAISO Control Area and opposes the WPTF/IEP proposal at this time.³⁴ Instead, Six Cities suggests the WPTF/IEP proposal be considered in later phases of MRTU after a thorough exploration of the issue through stakeholder review.³⁵

The CAISO agrees with the comments of SCE and Six Cities. It is important to note first that the existing CAISO Tariff (and the proposed MRTU Tariff) allows resources internal to the CAISO Control Area to provide AS to serve Loads in external Control Areas.³⁶ However, the objective of the CAISO AS markets (both currently and with implementation of MRTU) is to meet the WECC and NERC AS requirements for Load within the CAISO Control Area.³⁷ As SCE and Six Cities correctly explain, there is

³² See SCE Reply Comments at 22; Six Cities Reply Comments at 10-12.

³³ SCE Reply Comments at 22.

³⁴ Six Cities Reply Comments at 11

³⁵ *Id.* at 11-12.

³⁶ See Section 8.4.7.2 of MRTU Tariff (regarding on-demand obligations to serve loads outside the CAISO Control Area); *see also*, CAISO Reply Comments at 31-32, 152-153.

³⁷ See, e.g., Section 8.1 of MRTU Tariff. The CAISO contracts for AS not as a principal but as an agent for and on behalf of Scheduling Coordinators serving Load within the CAISO Control Area. See Section 22.13 of the MRTU Tariff.

no provision in either the CAISO Tariff (or the proposed MRTU Tariff) for entities to “bid” to supply or meet the AS requirements of loads outside the CAISO Control Area.

3. Clarification Regarding Export Rules (Both Energy Exports and AS Exports) Under MRTU

A number of comments on the MRTU Tariff Filing involve exports from the CAISO Control Area (both exports of Energy and exports of AS). Given these comments, and given the changes the CAISO has agreed to make in response to those comments, the following is a brief overview of the export functions available under MRTU (including the changes the CAISO agreed to make in its May 16 Reply Comments).

Exports of Energy. With regard to exports of Energy, both Bids and Self-Schedules to export Energy may be submitted in the IFM,³⁸ and the HASP.³⁹ Allowing self-scheduled exports in the HASP represents a change from what was filed on February 9, 2006; under the as-filed MRTU Tariff, one could not self-schedule exports in the HASP unless ETC rights or Transmission Ownership Rights (“TORs”) were being used.⁴⁰

³⁸ See, e.g., definition of Export Bid in Appendix A to MRTU Tariff and Section 11.2.1.4 of MRTU Tariff (charge to SCs for Energy Exports).

³⁹ Regarding Bids to Export Energy, see Section 33.1 of the MRTU Tariff (“Export Bids that are not Self-Schedules may be submitted in HASP”). Regarding Self-Schedules to Export Energy, so long as the capacity is non-RA capacity (in the IFM), and non-RA, non-RUC capacity (in HASP), entities may submit a Self-Schedule to export Energy. This functionality will be implemented using a manual procedure for Release 1. See CAISO Reply Comments at 124, 136.

⁴⁰ See Section 33.3 of the MRTU Tariff (“Scheduling Coordinators may not submit Self-Schedules for CAISO Demand or for exports to the HASP except for exports that utilized TORs and ETC rights that have post-Day-Ahead scheduling rights and except for Self-Schedules for wheel-throughs”). In response to comments, the CAISO proposed to change the tariff provisions and allow self-scheduled exports in HASP so long as the capacity is non-RA, non-RUC capacity. See CAISO Reply Comments at 124, 135-137.

Exports of AS. With regard to exports of AS, *Bids* to export AS are not available under either the existing CAISO Tariff or the MRTU Tariff.⁴¹ However, entities may arrange for exports of AS prior to the HASP by arranging for on-demand obligations to other Control Areas.⁴² The entity arranging an on-demand obligation must: (i) provide the electronic tag to the CAISO prior to the close of the Real-Time Market, (ii) use export transmission capacity available in Real-Time, (iii) make sure the resource capacity obligated to satisfy an on-demand obligation is not under a Reliability Must-Run (“RMR”) or Resource Adequacy obligation and has not been given a RUC schedule.

C. Resource Adequacy

1. The Commission Should Approve the Resource Adequacy Provisions as a Vital Component of the CAISO Market Design and the CAISO’s Responsibilities as Control Area Operator

In the recent order conditionally accepting the CAISO Interim Reliability Requirements Program (“IRRP”), the Commission reemphasized the importance of a resource adequacy requirement to the orderly functioning of the CAISO’s markets by quoting from its October 28, 2003 Order in which the Commission determined:

[A] resource adequacy element is a critical element to any market design. Specifically, we noted that a provision for resource adequacy helps customers by assuring adequate supplies, helps generation developers by creating a demand for resources in advance of electricity prices doing so alone, and protects customers from high spot market prices. Furthermore, a well developed resource adequacy plan can reduce risks associated with hastily developed supply resources, in response to high regional spot prices, which compromise long-term cost minimization, environmental concerns and fuel diversity goals.⁴³

⁴¹ See discussion in Section II.A.2 of this Answer, Section 8.4.7.2 of the MRTU Tariff, and CAISO Reply Comments at 31-32.

⁴² See Section 8.4.7.2 of the MRTU Tariff; *see also*, section 8.2.3.2 of the MRTU Tariff.

⁴³ See *California Independent System Operator Corp.*, 115 FERC ¶ 61,172 at P 3 (2006) (“IRRP Order”) quoting *Further Order on the Cal. Comprehensive Mkt. Design Proposal*, 105 FERC ¶ 61,140 at PP 205, 214 (October 28, 2003).

The Commission has clearly and consistently recognized the importance of minimum, generally-applicable resource adequacy obligations being imposed on LSEs as a vital component of reliable grid operations and reasonable wholesale prices. These requirements must respect the roles and responsibilities of state and Local Regulatory Authorities (“LRAs”) in determining siting and construction of facilities, specific procurement practices, and quality of service (so long as the determination does not affect the customers of other LRAs); however, the requirements must also support the ability of the CAISO to safely and reliably operate the CAISO Controlled Grid. Indeed, a resource adequacy program that failed to enhance Real-Time operations would be a wasted effort.

The CAISO’s Reply Comments discussed the CAISO’s planning and grid management responsibilities under state law, its Commission-approved tariff, WECC and North American Electric Reliability Council (“NERC”) criteria, and general Good Utility Practice. In order to meet these responsibilities, there must be basic requirements in the MRTU Tariff identifying:

- How much each Scheduling Coordinator is expected to supply in order to meet its resource adequacy obligation in a fair manner;
- How specific resources, such as Use-Limited Resources and imports, can meet the resource adequacy obligation;
- How to make sure resources can perform and be deliverable;
- How information as to what resources have been procured will be communicated to the CAISO;
- How the Resource Adequacy Resources will actually be made available to meet Demand;
- How the CAISO can procure backstop resources to meet its grid management responsibilities if SCs fall short; and

- What are the just and reasonable settlement practices for costs related to resource adequacy dispatch and backstop procurement.

Several parties reiterate a call to reject Sections 40 and 42 of the MRTU Tariff and suggest that the CAISO should be required to engage in additional stakeholder discussions to modify Section 42.⁴⁴ The CAISO strongly disagrees. Without Section 40, there would be no obligation to inform the CAISO in advance as to what resources would be made available, no obligation to secure resources that are physically capable of serving Demand when and where it is needed, and no obligation to actually make the resources available to the CAISO for Dispatch.⁴⁵ The CAISO has a responsibility to have sufficient resources available when needed to serve CAISO Control Area Demand and to administer a resource adequacy obligation that fairly apportions the burden of ensuring system reliability among the Scheduling Coordinators who utilize the facilities under the CAISO's Operational Control so that one entity does not lean on the supply procured by others.

Section 42 reflects the CAISO's existing authority to fulfill system planning responsibilities assigned to the CAISO under Assembly Bill 1890 ("AB 1890"). Parties' comments and protests regarding the foundation of Section 42 are, therefore, beyond the scope of this proceeding and constitute a collateral attack on the October 1997 Order of the Commission authorizing CAISO operations and the Order Accepting Amendment

⁴⁴ SWP Reply Comments at 14 (The Commission should reject both Sections 40 and 42 and FERC should order the CAISO to engage in a stakeholder process to develop alternative MRTU tariff provisions to address CAISO backstop procurement authority.); Metropolitan at 7 (Metropolitan supports the CPUC's request for Commission rejection of Sections 40 and 42, to permit the CAISO to engage in a stakeholder process to develop Tariff text that would reconcile the CAISO's need to procure energy in limited circumstances with an LRA's interest in maintaining reasonable rates for its ratepayers.).

⁴⁵ Lassen improperly suggests that Section 40 has been superseded by Docket No. ER06-723. Lassen Reply Comments at n.8. As the IRRP conditional approval in Docket No. ER06-723 will sunset with the implementation of the MRTU Tariff, the IRRP does not supersede the MRTU filing.

No. 30.⁴⁶ More importantly, without Section 42, the CAISO would lose its ability to exercise existing backstop procurement authority to satisfy its existing obligation to comply with Applicable Reliability Criteria. The CAISO has exercised this authority with prudence, demonstrating that the standards embodied in Section 42 are just and reasonable. No party has proven otherwise. Moreover as the Commission has recognized, the CAISO's need to rely on this authority should continue to be extremely limited as California Load-Serving Entities ("LSEs") secure sufficient resources in advance:

We will accept without modification the ISO's proposed Tariff Amendment No. 30 filed in Docket Nos. EL00-95-002 and EL00-98-002, and we will grant the effective date requested by the ISO. Regarding intervenors' concerns that the ISO be limited in its use of forward contracting, we believe that the findings made in this order, particularly those intended to significantly reduce underscheduling, will serve that purpose. To the extent that the ISO's need to procure energy for the real-time market will be significantly reduced, its need to procure energy through forward contracting will be lessened accordingly. In addition, with respect to the issue of the ISO's proposed allocation methodology, we find intervenors' arguments on this matter to be without merit. The proposed methodology merely allocates costs in a manner consistent with other such methodologies that we have accepted in the past, and no party has presented arguments which persuade us to reject it.⁴⁷

Sections 40 and 42 contain necessary tools for the CAISO to fulfill its obligations. With the termination of the Commission-imposed must-offer obligation, the CAISO must be able to count on SCs serving Load in the CAISO Control Area to make available a sufficient supply of resources consistent with the CAISO's short-term grid management practices, systems, and standards. In the rare instances or emergency situations where SCs do not fully meet those needs, the CAISO must have the authority to secure

⁴⁶ *Pacific Gas & Electric Company, et. al.*, 81 FERC ¶ 61,122 (1997); *San Diego Gas & Electric Co v. Sellers of Energy & Ancillary Servs., et al.*, 93 FERC ¶ 61,294 (2000).

⁴⁷ *San Diego Gas & Electric Co v. Sellers of Energy & Ancillary Servs., et al.*, 93 FERC at 62,020.

resources or otherwise risk triggering a System Emergency and potentially cascading failures. Rhetoric aside, the CAISO has never sought to supplant the role of LSEs in securing resources. To the contrary, the record is clear, and one has only to review the history of CAISO operations, tariff amendments, and supply contracts to see that the CAISO has constantly pushed for more forward contracting of resources by LSEs, better scheduling of those resources in advance of Real-Time operations, and minimization of the stress on the CAISO control room operations staff to engage in backstop procurement.

2. The Commission Should Approve the CAISO's Proposed Minimum Reserve Criteria

Silicon Valley Power (“SVP”) and Lassen object to FPL’s suggestion that FERC exercise exclusive jurisdiction over the resource adequacy program.⁴⁸ The CAISO agrees that the Commission need not exercise *exclusive* jurisdiction. The Commission does, however, have *concurrent* responsibilities to ensure reliable system operations and reasonable wholesale prices. Rather than approaching resource adequacy “cautiously” as recommended by CMUA,⁴⁹ the CAISO would suggest that resource adequacy be handled in a consistent and comprehensive manner.

The CAISO proposed a 15% minimum planning Reserve Margin because such a level is: (1) consistent with that established by the CPUC; (2) consistent with the criteria used by the WECC in its planning assessments; and (3) as noted by the Commission, comparable to what is used in many parts of the country.⁵⁰ Further, the CAISO proposed

⁴⁸ Cities/M-S-R Reply Comments at 28; Lassen Reply Comments at 3-7. *See also* Bay Area Reply Comments at 16-17 (objecting to the suggestion that the Commission should exercise its exclusive right to pricing in the resource adequacy program, as this would be an illegal usurpation of local authority).

⁴⁹ CMUA Reply Comments at 5.

⁵⁰ IRRP Order, 115 FERC ¶ 61,172 at P 36.

this Reserve Margin as a threshold, instead of a default criteria as was approved in the IRRP, because there is a greater concern in the context of the longer-term MRTU program that the resource adequacy requirements be consistent. It is contemplated that in the post-MRTU timeframe, only resources subject to a resource adequacy requirement will be *required* to participate in the CAISO's IFM and those Resource Adequacy Resources not cleared in the IFM must participate in RUC with a \$0 RUC Bid. RUC capacity costs, if any, will be allocated first on a MW for MW basis to Demand that was not scheduled in the IFM. Thus, a minimum capacity requirement on all LSEs promotes system reliability and that prevents one LSE from adopting a low Reserve Margin knowing it is likely able to lean on the resources of other LSEs for most of the days of the month without cost consequences. This happens, for instance, because on most non-peak days, excess resource adequacy capacity may be available through RUC to underscheduled load at no cost. Indeed, the CAISO noted this concern in its Reply Comments in response to WAPA's initial comments on the MRTU Tariff, in which WAPA proposed only a 5% Reserve Margin.

Several of the municipals indicate that the issue is not really the 15% Reserve Margin *per se*, but rather that the Reserve Margin is in the MRTU Tariff as a condition of service. As stated by Lassen, "Lassen is not arguing that it and other Non-CPUC LSEs should be subject to reduced standards, such as a lower planning reserve requirement than CPUC-LSEs. Lassen is merely requesting that the jurisdiction over such a decision is properly left to the LRA."⁵¹ Cities/M-S-R and Bay Area make similar statements.⁵² These parties, therefore, recognize that no LSE should be allowed to lean on other LSEs.

⁵¹ Lassen Reply Comments at 6.

⁵² Cities/M-S-R Reply Comments at 31 and Bay Area Reply Comments at 19.

It is obviously more reasonable to have a consistent, minimum criteria applicable to all LSEs in the CAISO Control Area. However, if Section 40 were to unjustly or unreasonably interfere with the resource adequacy program adopted by an LRA or otherwise discriminate against an LRA, it would be subject to modification by the Commission, if the CAISO does not voluntarily undertake any required revision. The Commission, the CAISO, the CPUC, other LRAs, and Market Participants must work together to ensure safe and reliable grid operations and a stable electric market. The CAISO recognizes the concern expressed by the CPUC that a conflict could arise if both the CPUC and the CAISO were to determine Demand and set semi-parallel reliability requirements.⁵³ The solution, however, cannot be to have a tariff devoid of resource adequacy obligations, but rather a regular and open process of communication as all parties work to implement a comprehensive and effective resource adequacy program for California.

There should be agreement as to minimum resource procurement standards and a means to have the purchased resources made available to support grid operations. This requires certain generally-applicable obligations to ensure the burden is borne fairly by all who benefit from stable grid operations. The CAISO has tried through its participation in CPUC proceedings, through the CAISO stakeholder process, and through the compromises reflected in the MRTU Tariff to propose such just and reasonable and generally-applicable provisions that properly reflect the determinations of the CPUC and other LRAs. The CAISO recognizes that this is the beginning of a joint effort and that, with actual experience under the resource adequacy program, the parties need to work together to fine tune these provisions, as necessary.

⁵³ CPUC Reply Comments at 4.

CCSF argues that the CAISO is double-counting the Reserve Margin in requiring LSEs to provide a percentage of their daily Demand to the CAISO, as Day-Ahead forecasts will already include such matters as weather and outages.⁵⁴ CCSF contends that the CAISO proposal would result in an LSE planning reserve of 122% to 125%, instead of the appropriate 107% of Demand plus Ancillary Services required of other LSEs.⁵⁵

The CAISO disagrees with CCSF. As the CAISO clarified in its Reply Comments,⁵⁶ the 15% Reserve Margin encompasses Operating Reserves. Thus, the CAISO's proposal is 115% of Demand only, which is consistent with CCSF's own proposal of 107% plus Ancillary Services (107% + 7% (114%)). Moreover, there is still variation after the Day-Ahead forecasts for weather and outage-related events.

3. The Commission Should Approve the CAISO's Proposal for Use-Limited Resources

CCSF argues that the CAISO should be required to accept the limitations that encumber many municipal resources, and to clarify that such resources "count toward a non-CPUC utility meeting its resource adequacy needs despite ... dispatch limitations."⁵⁷ The CPUC alleges that the CAISO improperly creates a veto for counting Use-Limited Resources notwithstanding CPUC efforts with respect to such resources and that the CAISO makes improper changes to the Participating Intermittent Resource Program ("PIRP") for counting purposes.⁵⁸ These comments unfairly characterize the proposed provisions in the MRTU Tariff concerning Use-Limited Resources.

⁵⁴ CCSF Reply Comments at 12.

⁵⁵ *Id.*

⁵⁶ *See* CAISO Reply Comments at 227.

⁵⁷ CCSF Reply Comments at 10 (Without such clarification, municipal utilities might face a "paper" de-rating, in which their actual ability to serve load is not reflected in the resource adequacy determination).

⁵⁸ CPUC Reply Comments at 6.

Indeed, the CAISO developed the proposed Section 40.6.4 of the MRTU Tariff in recognition that there was an important class of resources that needed to be accounted for in satisfying Reserve Margin obligations but which had limitations on their availability. The CAISO's approach is to have the relevant SC submit a use plan specifying how the Use-Limited Resources may be dispatched by the CAISO. Simply put, the SC and resource owner retain control of the Dispatch of the facility absent exigent circumstances that permit greater control by the CAISO. CCSF fails to specify how the CAISO's proposed MRTU Tariff provisions do not address its concerns. Without such an explanation, the Commission should reject CCSF's conclusory statements.

In addition, the CPUC is incorrect that the CAISO is making improper changes to PIRP. First, it is important to recognize that the CAISO has not proposed significant changes to PIRP, but as discussed in its Reply Comments, has proposed to conform the existing program to the new market design.⁵⁹ Second, an intermittent resource does not have to participate in PIRP in order to provide Qualifying Capacity, if the resource is acceptable under the resource adequacy program of the LRA.⁶⁰ As to the CPUC's concern that the MRTU Tariff gives the CAISO a "veto" over the determination of whether or not a facility qualifies as Use-Limited, the CAISO submits that the proposal in Section 40.6.4.1 is consistent with the CAISO's role in verification of resources capabilities through testing and certification. It is important to recognize that these are predominately existing facilities with which the CAISO has successfully operated for years by respecting environmental and other concerns that would restrict the facility's availability.

⁵⁹ CAISO Reply Comments at 254-256.

⁶⁰ Section 40.8.1.6 is a default provision applicable only if the LRA does not have criteria as to what resources can provide Qualifying Capacity.

4. The CAISO Is Deferring to LRAs as to the Acceptable Level of Local Service Reliability Within Their Jurisdiction

NCPA alleges that the Local Capacity procurement requirement is overstated through use of double contingency N-2 reliability criteria with no Load shedding, claiming that this standard is more stringent, and more expensive, than NERC criteria.⁶¹ The CAISO disagrees that the criteria it has used for its Local Capacity study are overly conservative. The Applicable Reliability Criteria currently require, among other things, adequate local generation, and associated telemetry and control, to ensure the grid can survive any single contingency (N-1). The Applicable Reliability Criteria also require adequate resource adjustments by the CAISO to prepare for the next contingency after the actual occurrence of a first contingency (N-1-1).⁶²

The CAISO recognizes that N-1-1 criteria, as well as the N-2 contingency (two elements out of service), may be satisfied by various options, including generation commitment, transmission switching, planned or controlled Load interruption, or a combination thereof. Accordingly, the CAISO stated in its Reply Comments:

In this regard, the CAISO will allow the CPUC and other LRAs to select or reject those operating solutions, such as Remedial Action Schemes, that result in manual or automatic shedding of firm Load, where permitted under NERC and WECC standards, to achieve the Applicable Reliability Criteria. As such, the CAISO intends to respect the role of the CPUC and LRAs in determining acceptable levels of End-Use Customer service reliability. In other words, the CPUC and LRAs may satisfy the CAISO's

⁶¹ NCPA Reply Comments at 10.

⁶² The CAISO planning criteria generally allows for load shedding for the double contingencies. However, the CAISO has, consistent with its Tariff, conducted planning studies that maintain the level of reliability that existed prior to its formation. This is referred in the MRTU Tariff as "Local Reliability Criteria," which, along with NERC Planning Standards discussed below, form the CAISO's "Applicable Reliability Criteria." The CAISO is under an obligation to implement Local Reliability Criteria, unless modified pursuant to agreement with the relevant Participating Transmission Owner ("PTO"). As such, to the extent a PTO's pre-CAISO standards did not allow for load shedding for common corridor and/or double circuit tower line outages, the CAISO has maintained that practice to assure that the level of reliability that prevailed before the CAISO was formed would be maintained and the CAISO remains in compliance with its obligations.

identified local reliability needs by exercising their jurisdiction over LSEs to compel procurement of generation resources or demand response products to meet the needed Local Capacity, which already reflects CPUC or LRA decisions regarding whether LSEs within their respective jurisdiction can utilize controlled Load interruption options to ensure Grid reliability in accordance with Applicable Reliability Criteria. Further, under Section 40.3.2, the CAISO would defer to the CPUC with respect to its allocation of the Locational Capacity Resource Obligation for all CPUC-Load Serving Entities.⁶³

In its 2007 Local Capacity Technical Analysis,⁶⁴ the CAISO identified three different options as to service reliability that would be consistent with the with CAISO's

Applicable Reliability Criteria:

- (1) Meet Performance Criteria Category B. This is a service reliability level that reflects generation capacity that must be available to comply with reliability standards for NERC Category B given that Load cannot be removed to meet this performance standard under Applicable Reliability Criteria. However, this capacity amount implicitly relies on load interruption as the only means of meeting any Applicable Reliability Criteria that is beyond the loss of a single transmission element (N-1). These situations will likely require substantial Load interruptions in order to maintain system continuity and alleviate equipment overloads including Load interruptions prior to the actual occurrence of the second contingency.
- (2) Meet Performance Criteria Category C and Incorporate Suitable Operational Solutions. This is a service reliability level that reflects generation capacity that is needed to readjust the system to prepare for the loss of a second transmission element (N-1-1) using generation capacity after considering all reasonable and feasible operating solutions (involving customer load interruption) developed and approved by the CAISO, in consultation with the PTOs. Under this option, there is no expected Load interruption to end-use customers as the CAISO operators prepare for the second contingency. However, the customer Load will be interrupted in the event the second contingency occurs.
- (3) Meet Performance Criteria Category C through Pure Procurement. This is a service reliability level that reflects generation capacity that is needed to readjust the system to prepare for the loss of a second transmission element (N-1-1) using generation capacity only.

⁶³ CAISO Reply Comments at 200-201.

⁶⁴ <http://www.caiso.com/17e2/17e2851b23400.pdf>.

As the grid operator, the CAISO *recommended* option 2, noting that, on a day-to-day basis, the CAISO has traditionally operated the network based on the N-1-1 contingency, with operating solutions developed with the Participating TOs. The CAISO did not propose to “impose” this criterion on the CPUC. To the contrary, the CAISO is willing to defer to the LRA as to the acceptable level of service reliability within the LRA’s jurisdiction to the extent consistent with meeting Applicable Reliability Criteria, and commits to making this clear in the MRTU Tariff in a compliance filing.

The CAISO submits that this proposal enables the CAISO to fulfill its responsibilities under AB 1890 “to give the [CAISO] the ability to secure generating and transmission resources necessary to guarantee achievement of [those] planning and operating reserve criteria,”⁶⁵ while also properly reflecting the LSEs responsibilities under AB 380 to maintain adequate physical generating capacity.

CCSF argues that ETCs should count towards Local Capacity Requirements in terms of cost allocation, stating that ETCs used for deliveries within the CAISO should be treated no differently than ETCs used for imports – they should be given full resource adequacy credit.⁶⁶ This is an inaccurate characterization and it misconstrues the physical attributes of the transmission grid captured by the CAISO local capacity requirements. From a technical standpoint, the CAISO must have a minimum amount of capacity within a Load pocket to allow the maximum amount of imports into the area due to the transmission constraints that geographically define the local area. In other words, the CAISO’s local capacity requirements study does take into account Energy imported into the Load pockets and identifies the capacity requirement that allows the Energy to be

⁶⁵ See Assembly Bill 1890, ch. 2.3 art. 3, §§ 345-46.

⁶⁶ CCSF Reply Comments at 7-9.

imported and while maintaining grid reliability. Accordingly, the CAISO has not ignored CCSF's import practices, which are reflected in CCSF's financial ETC rights.

5. Resource Adequacy Capacity Must Actually Be Made Available To the CAISO

CCSF states that “Nothing in AB 380 requires LSEs to make their resources available to the CAISO to be dispatched at the ISO’s sole discretion.”⁶⁷ NCPA argues that LSEs should be permitted to use the capacity they are required to acquire to serve their own Load.⁶⁸ PG&E is “alarmed” over the proposed MRTU offer requirements for hydroelectric facilities.⁶⁹ These comments are either incorrect or fail to recognize the role of resource adequacy in the MRTU market design.

First, the concern that resources are being dispatched at the CAISO’s “sole discretion” seems grounded in the fear that the CAISO will engage in an arbitrary and capricious approach to the dispatch of resources. This fear is unfounded. The CAISO is using the same optimization approach applied in other markets to ensure all Demand, including that of CCSF, is served at the lowest cost. As to NCPA’s statement that LSEs be permitted to use their own resources to serve their own Load, the CAISO would restate the comment so that all LSEs are to make appropriate amounts of resources available for dispatch through Bids so that the Demand can be served in an optimal manner. A significant benefit of the MRTU market is the termination of the balanced schedule requirement and the use of a bid-based optimization. If entities, such as NCPA, bid generation sufficient to meet their Demand, they will be protected from the imbalance penalties that would be assessed for underscheduling. If, however, the NCPA Demand

⁶⁷ CCSF Reply Comments at 9-10.

⁶⁸ NCPA Reply Comments at 4.

⁶⁹ PG&E Reply Comments at 18-19.

can be served at lower cost to NCPA from other generation, they are benefited by the CAISO's optimization.

PG&E's concern over the requirements placed on hydroelectric facilities are inaccurate and exaggerated. The CAISO's Use-Limited Resource program allows the SC for the hydroelectric or other Non-Dispatchable Use-Limited Resource to protect the operation of the facility. Section 40.6.4.3.2 merely proposes that hydroelectric and other Non-Dispatchable Use-Limited Resources make themselves available based on "expected available Energy or their expected as-available Energy, as applicable, in the Day-Ahead Market and HASP." This is not the CAISO's "expected" available Energy. Rather, it is the resource scheduler's expected Energy. This provision provides the common-sense requirement that the resource should submit an Energy Bid or Self-Schedule when the resource owner believes it is available. Thus, the CAISO has granted the owners of hydroelectric and other Non-Dispatchable Use-Limited resources discretion when to make their resources available in the CAISO's markets.

CCSF contends that Modified Reserve Sharing LSEs should be treated the same as other LSEs in using resources to meet their demand during outages.⁷⁰ The CAISO disagrees. Given the overall benefits and burdens of the Modified Reserve Sharing LSE option, it is appropriate that, in the event of an outage of a Resource Adequacy Resource committed in the Day-Ahead Market, the SC for the Modified Reserve Sharing LSE would have up to the next HASP bidding opportunity plus one hour to replace the lesser of: (1) the committed resource suffering the forced outage, (2) the quantity of Energy committed in the Day-Ahead Market, or (3) 107% of the hourly forecast Demand. The Modified Reserve Sharing LSE option is a "bottom-up" approach that allows for shaping

⁷⁰ CCSF Reply Comments at 13.

of anticipated Demand on an hour-by-hour basis. In contrast, the Reserve Sharing LSE option is “top down” focusing on 115% of the peak Demand forecast for the month. To account for the difference in the amount of reserves procured for the non-peak hour, it is appropriate to place additional requirements on the Modified Reserve Sharing LSE to make-up for units suffering forced outages. This is also why, in contrast to the position taken by CCSF,⁷¹ the CAISO believes that the penalties on Modified Reserve Sharing LSEs that do not meet their resource adequacy obligations should not be restricted to times of peak Demand.

6. The MRTU Tariff Must Allow the CAISO To Continue Its Ability To Secure Backstop Resources To Meet Its Responsibilities for Reliable Grid Operations if an SC Fails To Provide Sufficient Resources To Meet Its Demand

Several parties continue to protest the CAISO’s backstop procurement authority, which, as noted above, is largely based on existing CAISO Tariff provisions. The CPUC argues that the backstop procurement mechanism generally ignores market power concerns and costs of procurement.⁷² NCPA supports PG&E’s arguments that the MRTU proposal could result in “reliability at any price.”⁷³ PG&E complains that Section 42.1.3 would give the CAISO authority to procure to “such more stringent criteria as the CAISO may impose.”⁷⁴ PG&E also agrees with SCE that the proposed MRTU Tariff should be revised to clearly prohibit CAISO local capacity procurement from resources under an RMR contract.⁷⁵

⁷¹ *Id.*
⁷² CPUC Reply Comments at 5.
⁷³ NCPA Reply Comments at 9-10.
⁷⁴ PG&E Reply Comments at 17-18.
⁷⁵ PG&E Reply Comments at 22-23.

With respect to Section 42.1.3, as indicated below this provision is existing tariff authority, including the authority to impose criteria more stringent than that adopted by NERC or the WECC:

~~42.1.3~~ ~~40.3.1.3~~ If the forecast shows that the ~~applicable~~ Applicable WECC/NERC Reliability Criteria cannot be met during peak Demand periods, then the CAISO shall facilitate the development of market mechanisms to bring the CAISO Controlled Grid during peak periods into compliance with the Applicable Reliability Criteria (or such more stringent criteria as the CAISO may impose pursuant to Section 7.2.2.2). The CAISO shall solicit ~~b~~Bids for Replacement Reserves in the form of Ancillary Services, short-term Generation supply contracts of up to one (1) year with Generators, and Load curtailment contracts giving the CAISO the right to reduce the Demands of those parties that win the contracts when there is insufficient Generation capacity to satisfy those Demands in addition to all other Demands. The curtailment contracts shall provide that the CAISO's curtailment rights can only be exercised after all available Generation capacity has been fully utilized unless the exercise of such rights would allow the CAISO to satisfy the Applicable Reliability Criteria at lower cost, and the curtailment rights shall not be exercised to stabilize or otherwise influence prices for power in the Energy markets.

This does not mean that the CAISO has utilized such more stringent criteria, only that if required by Good Utility Practice, the CAISO would have the authority to do so. Section 7.2.2.2 of the current CAISO Tariff which is Section 7.3.2 of the proposed MRTU Tariff provides that the CAISO Governing Board may establish planning guidelines more stringent than those established by NERC and WECC as needed for secure and reliable operation of the CAISO Controlled Grid. The definition of Applicable Reliability Criteria specifies it is “reliability standards established by NERC, WECC, and Local Reliability Criteria, as amended from time to time, including any requirements of the NRC.”⁷⁶ Moreover, under Section 5.1.5 of the Transmission Control Agreement, the

⁷⁶ “Local Reliability Criteria” are Reliability Criteria unique to the transmission systems of each of the Participating TOs established at the CAISO Operations date or the date on which the facilities were turned over to CAISO Operational Control.

CAISO may develop and promulgate Applicable Reliability Criteria, “in consultation with Participating TOs and other Market Participants.” Accordingly, the purported specter of an autocratic CAISO imposing unreasonable requirements is unrealistic and unfounded.

Finally, the CAISO agrees with PG&E and SCE that procurement of Local Capacity should be separate from RMR procurement in order to prevent double-recovery of capacity payments for making the same unit available to the CAISO.

7. The CAISO Agrees All LRAs Should Be Informed of Resource Adequacy Resources Failing Compliance Tests

SVP contends that Section 8.9.7(a) of the MRTU Tariff should be modified so that the CAISO would report a Resource Adequacy Resource’s failure to pass a compliance test to the applicable LRA not just the CPUC.⁷⁷ The CAISO agrees that a test failure should be reported to the applicable LRA and commits to make this change in a compliance filing.

D. Demand Response Under MRTU

1. The CAISO Will Provide Release 1 Functionality for Participating Load

SWP expresses concern with respect to the dispatch functionality that the CAISO will provide to Participating Load under Release 1. Specifically, SWP states that it has been told that Participating Load will only be permitted to submit AS Bids with two Dispatch Operating Points. SWP argues that such treatment departs from current CAISO practice and would unduly discriminate against demand-side resource because, under this system, SWP would be forced to take

⁷⁷ Cities/M-S-R Reply Comments at 29-30; *see also* Six Cities Initial Comments at 11.

the unacceptable operational risk of being instructed to shut down the entire amount of its Participating Load.⁷⁸

SWP is correct in that under MRTU, Release 1, the Pump/Participating Load model will utilize the negative generation model used for modeling pump/storage resources. As a result of the need to change the settlement of Participating Loads in order to avoid the potential “money machine” opportunity reported by LECG,⁷⁹ and other design and validation rules, the CAISO decided to defer consideration of a unique model for dispatching Dispatchable Demand Response and Participating Load resources to Release 2. However, in recognition of the fact that most of the active Participating Loads in the CAISO Control Area are actually large hydro pumps, the CAISO has committed to support the ability of these demand response resources to participate in the CAISO markets in Release 1 by utilizing a negative generation model. Under this model, these Participating Loads will be treated as follows:

- Bid Components – Resources will submit a two-part Bid that includes shut-down curtailment costs and pump energy costs.
- Number of Operating Bid Segments – Single segment. These resources will be treated as either all on or all off.
- Aggregation – The pump/storage model for Release 1 will not support aggregation of individual pumps or Load.

⁷⁸ SWP Reply Comments at 10-11.

⁷⁹ “Comments on the California ISO MRTU LMP Market Design,” Attachment A to the CAISO’s May 13 2005 MRTU Filing at 62.

- Day-Ahead Market Treatment – These resources will be modeled as a negative Generator and can only submit offers to buy in the Day-Ahead Market.
- Real-Time Market Treatment – In Real-Time, these resources may offer to curtail from their Day-Ahead Market schedule (if scheduled in the Day-Ahead Market) or offer to pump in the Real-Time Market if they are not scheduled to pump in the Day-Ahead Market.
- HASP Treatment – These resources will be permitted to self-schedule in the HASP. However, once self-scheduled in HASP these resources may not also offer to buy and sell in the Real-Time Market.
- Settlements - In the Day-Ahead Market, these resources can only bid to buy Energy. If scheduled, the pump Loads are charged the applicable Day-Ahead Market LMP. If they are not scheduled in the Day-Ahead Market, they incur no charges. In Real-Time, any curtailments from the Day-Ahead Market schedule will be settled at the nodal LMP plus any shut-down curtailment costs subject to Bid Cost Recovery.
- Ancillary Services – Eligible to provide Non-Spinning Reserves.
- Inter-Temporal Constraints – None.
- Load Ramping – Not supported.

This model, used to support large participating pump Load, can also be used to support other Participating Load that has characteristics that similar to large pump Load.

For implementation as part of Release 2, the CAISO intends to consider a more flexible model for Participating Loads to bid into the CAISO markets. The CAISO also expects that such a model will be able to support either individual Load or aggregated Load under a custom Load aggregation scheme, and thus, will fully resolve the issues raised by SWP. Nevertheless, in order to address SWP's concerns with respect to the Release 1 model, the CAISO will continue to investigate the feasibility of implementing a non-software workaround to the aggregation limitation embodied in the negative generation model.

2. The Specific Concerns Raised by Parties with Respect to the Treatment of Participating Load under MRTU Do Not Impact on the Justness and Reasonableness of the CAISO's MRTU Proposal

Several parties raise, in their reply comments, other specific issues concerning the CAISO's treatment of Participating Load and demand response under MRTU. Most of these issues were addressed in the CAISO's May 16 Reply Comments. SWP reiterates arguments that certain steps should be taken to provide for Participating Load under MRTU. Specifically, that: (1) Participating Load should be permitted to schedule in the HASP; (2) Participating Load should be dispatched only to the extent that it has bid into the CAISO markets to do so; (3) Participating Load Supply Bids that are accepted into CAISO markets should be settled on the same basis as generators' Supply Bids; and (4) Energy consumption by Participating Loads should be billed for all Energy on a nodal basis.⁸⁰ In its Reply Comments, the CAISO agreed that Participating Loads should be included in the definition of "Supply" so as to allow Participating Loads to self-schedule in the HASP and be treated as a negative generator, and will make that change in a

⁸⁰ SWP Reply Comments at 5-6.

compliance filing.⁸¹ The CAISO also agreed that there are instances in the MRTU Tariff where “Generators” should more accurately read “Generators and Participating Loads,” including some of the examples that SWP highlights. The CAISO pledged to work with SWP to identify and correct such instances in its compliance filing.⁸² The CAISO explained that Participating Loads will be scheduled and settled at the nodal level, rather than the LAP level, in the Day-Ahead and Real-Time Markets and will add that further clarification to Section 30.5.3.2 of the MRTU Tariff in its compliance filing.

With respect to SWP’s argument regarding the dispatch of a Participating Load that has not bid into the CAISO’s markets, the CAISO will not dispatch a Participating Load unless it has bid into the CAISO’s markets. The only exception to this general rule is that the CAISO may dispatch a Participating Load that has not submitted a Bid, if necessary, pursuant to its Exceptional Dispatch authority. In response to SWP’s concerns that dispatching Participating Load that has not bid into the CAISO’s markets could cause flooding or damage SWP’s water management equipment, however, the CAISO notes that Section 34.9 of the MRTU Tariff requires the CAISO to conduct all Exceptional Dispatches consistent with Good Utility Practice. This means that the CAISO would not require Participating Load to respond under the circumstances described by SWP.

The CPUC contends that its resource adequacy program allows for demand response resources that meet certain deliverability criteria to count as qualifying

⁸¹ This response also addresses the concern raised by PG&E that MRTU Release 1 would preclude SCs from bidding Participating Load resources into the HASP markets. *See* PG&E Reply Comments at 20-21. With respect to PG&E’s contention that MRTU Release 1 should allow Participating Load resources to bid into the Day-Ahead Market, the CAISO, in its Reply Comments, explained why it is appropriate to defer integration of PL into the Day-Ahead Market until after Release 1. CAISO Reply Comments at 323.

⁸² This commitment also extends to any other interested parties.

resources, but the CAISO's market rules do not fully reflect this policy.⁸³ The CAISO is not clear on how the CAISO's market rules fail to reflect the CPUC's treatment of demand response resources, and the CPUC provides no details as to why this is the case. Nothing in the MRTU Tariff prohibits the designation of demand response resources as Resource Adequacy Resources, and therefore, capacity from such resources can be counted as Qualifying Capacity, provided that doing so is consistent with the eligibility rules established by the CPUC and applicable LRAs.

3. The CAISO Has Committed to Exploring Additional Opportunities for Demand Response Resources in MRTU After Release 1

Several parties reiterate their requests for greater accommodation of other Participating Loads under MRTU Release 1.⁸⁴ As stated in its May 16 Reply Comments, the CAISO agrees that an expanded role for Demand Response/Participating Loads should be considered for development and implementation post-Release 1. The CAISO disagrees, however, that it is necessary to implement expanded opportunities for demand response resources as part of Release 1.⁸⁵ As the CAISO explained in its May 16 Reply Comments, MRTU Release 1 will accommodate all Participating Loads that are participating in the current CAISO markets, *i.e.*, pumping Loads.⁸⁶ The CAISO agrees that providing opportunities for other demand response resources to participate in the CAISO markets post-Release 1 is a desirable goal, and commits to work with stakeholders in order to develop such mechanisms for integration into MRTU Release 2. However, the fact that such opportunities will enhance the MRTU design does not render

⁸³ CPUC Reply Comments at 25.

⁸⁴ SWP Reply Comments at 9-10; PG&E Reply Comments at 20.

⁸⁵ SWP Reply Comments at 5-7; CPUC Reply Comments at 25.

⁸⁶ CAISO Reply Comments at 266.

the CAISO's Release 1 design unjust or unreasonable. The CAISO is only required to show that the Release 1 design is just and reasonable as filed, not that it is superior to all possible alternatives.⁸⁷ There is nothing in the nature of the MRTU markets, as compared to the current market design, that makes it particularly crucial or necessary to provide additional provisions for demand response resources under Release 1, such that without such additional provision the MRTU design would be flawed or incomplete. Therefore, given that the CAISO's current provisions for accommodating demand response resources are just and reasonable, the CAISO's MRTU proposal is not rendered unjust or unreasonable by virtue of the fact that it will not provide, initially, additional opportunities for demand response resources to participate in the CAISO markets beyond those provided under the current market design.

E. Marginal Losses

Under MRTU, Marginal Losses are incorporated into LMPs. Doing so is important for assuring least-cost Dispatch and for establishing nodal prices that accurately reflect the cost of supplying the Load at each node. As the CAISO explained in its May 16 Reply Comments, this aspect of the CAISO's MRTU design was approved by the Commission in a number of prior orders and is consistent with the Commission's orders on other ISOs and RTOs finding the benefits of incorporating Marginal Losses into LMPs.⁸⁸

⁸⁷ See *New England Power Co.*, 52 FERC ¶ 61,090 at 61,336 (1990), *reh'g denied*, 54 FERC ¶ 61,055 (1991), *aff'd Town of Norwood v. FERC*, 962 F.2d 20 (D.C. Cir. 1992); *citing City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir.), *cert. denied*, 469 U.S. 917 (1984) (utility need only 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.”).

⁸⁸ CAISO Reply Comments at 58-60.

As is well known, the incorporation of Marginal Losses into LMPs results in the over-collection of revenue by the CAISO. In the MRTU Tariff Filing, the CAISO proposed a new method for allocating the Marginal Loss surplus (defined in the MRTU Tariff as the “IFM Marginal Losses Surplus Credit”), specifically proposing to allocate the IFM Marginal Losses Surplus Credit to the total MWh of Measured Demand in the CAISO Control Area for the relevant Settlement Period.⁸⁹ This approach is generally consistent with the allocation of Marginal Loss surpluses at other ISOs and RTOs.⁹⁰ The Commission should therefore approve the CAISO’s proposal that IFM Marginal Losses Surplus Credit should be allocated to Measured Demand under the MRTU Tariff.

In both its initial and reply comments, PG&E raises a concern about the specific methodology for allocating IFM Marginal Losses Surplus Credits to Measured Demand. Specifically, PG&E is concerned that the CAISO’s allocation methodology will result in significant cost shifts “result[ing] from historical differences between areas of the grid and of load density.”⁹¹ In its May 16 Reply Comments, the CAISO explained that neither PG&E nor the CAISO has undertaken studies to determine whether PG&E’s theoretical concern will materialize under the MRTU markets and that, barring evidence of

⁸⁹ See MRTU Tariff Filing Letter at 17-18 and Section 11.2.1.6 of the MRTU Tariff.

⁹⁰ See, e.g., *Central Hudson Gas & Electric Co., et al.*, 88 FERC ¶ 61,138 at 61,384-85 (1999) (“Under the marginal loss proposal, revenue collected for losses will exceed the actual costs for losses. The excess revenue collected above costs will be offset against the scheduling charge which is paid by all entities scheduling load in New York.”); *Northeast Utilities Service Company et al. v. ISO New England, Inc. et al.*, 109 FERC ¶ 61,204 at P 3 (2004) (noting that, under ISO-NE’s market design excess loss revenues are “refunded to participants based on their net real-time adjusted load obligations over all locations”). The approaches adopted by these ISOs and RTOs are generally consistent with allocation to Measured Demand because the MRTU Tariff, unlike the tariff provisions of other ISOs and RTOs, distinguishes between “Demand” and “Load.”

⁹¹ PG&E Reply Comments at 8.

significant cost shifts, there is no reason to conclude that the CAISO's IFM Marginal Losses Surplus Credit allocation methodology is not reasonable.⁹²

Since filing the May 16 Reply Comments, the CAISO has undertaken a preliminary assessment of PG&E's concerns. The CAISO intends to study the issue raised by PG&E and to make the results of this study available to all stakeholders. Because the allocation methodology is neither a core element of the MRTU design nor a critical path component of the MRTU software, this study process should not delay the MRTU implementation schedule or delay a Commission order on the MRTU Tariff Filing. Specifically, there is no reason to delay a Commission order approving: (1) the terms and conditions of the MRTU Tariff related to the incorporation of Marginal Losses in LMPs and (2) the principle that IFM Marginal Losses Surplus Credits should be allocated to Measured Demand.

F. Objective of the CAISO's Optimization Methodology

SCE comments that the optimization methodology proposed by the CAISO "may result" in inaccurate charges to customers, incorrect unit commitment, and should be improved when technically possible.⁹³ SCE also argues that "production cost minimization" should not be the objective of the CAISO optimization; rather, according to SCE, the objective of the optimization should be "payment minimization."⁹⁴ The CAISO has reviewed the papers provided by SCE to support this approach and found this approach to be at a very preliminary stage of development. This approach therefore should not be viewed by the Commission as a viable alternative to the CAISO's filed proposal.

⁹² CAISO Reply Comments at 61-62.

⁹³ SCE Reply Comments at 41.

⁹⁴ *Id.*

CONCLUSION

Wherefore, for all the reasons stated in the MRTU Tariff Filing, in the CAISO's May 16 Reply Comments, and in the Answer above, the CAISO respectfully requests that the Commission find that the terms and conditions of the MRTU Tariff are just and reasonable and that the record concerning the MRTU Tariff is sufficiently developed that the Commission can approve the MRTU Tariff Filing without hearings or additional procedures prior to the Commission's order. The Commission should reject comments seeking substantial alterations to the MRTU Tariff and accept the MRTU Tariff with only those clarifications and revisions the CAISO committed to make in its May 16 Reply Comments and commits to make in the instant Answer.

Respectfully submitted,

/s/ Sidney M. Davies
Charles F. Robinson
General Counsel
Sidney M. Davies
Assistant General Counsel
Anna McKenna
Counsel
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-4400

Sean A. Atkins
Michael Ward
Michael Kunselman
Alston & Bird LLP
The Atlantic Building
950 F Street NW
Washington, DC 20004
Tel: (202) 756-3300

Roger Smith
David B. Rubin
Christopher R. Jones
Karen J. Kruse
Troutman Sanders LLP
401 9th Street, N.W., Suite 1000
Washington, D.C. 20004
Tel: (202) 274-2950

Dated: June 2, 2006

Certificate of Service

I hereby certify that I have this day served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 2nd day of June, 2006 at Folsom in the State of California.

/s/ Helen Iliopoulos

Helen Iliopoulos