

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

**California Independent System) Docket No. ER08-519-000
Operator Corporation)**

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

Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213 (2007), the California Independent System Operator Corporation (“CAISO”) respectfully requests leave to file an answer (“Answer”) and files this Answer to the limited protest submitted by Citadel Energy Products, LLC, *et al.*, in this proceeding on February 15, 2008, and pursuant to Rule 213, the CAISO also files its answer to the comments submitted in this proceeding by other parties on the same date.¹ For the reasons explained below, the CAISO respectfully requests that the Commission accept the amendments to the CAISO Tariff as proposed in its January 31, 2008, filing in this proceeding, with the clarifications and refinements provided in this Answer.

I. BACKGROUND

On January 31, 2008, the CAISO submitted in the above-referenced proceeding a proposed amendment to its tariff (“CRR Contingency Plan Amendment” or “Amendment”) to implement components of a contingency plan

¹ Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the CAISO Tariff.

("CRR Contingency Plan") to address the treatment of Congestion Revenue Rights ("CRRs") and Firm Transmission Rights ("FTRs") in light of a delay of uncertain length of the implementation date of the CAISO's Market Redesign & Technology Upgrade ("MRTU") program, which was scheduled to be implemented as of the April 1, 2008 Trading Day. On February 6, 2008, the CAISO filed a substitute certificate of service and a request for any necessary waiver of the Commission's prior notice requirement in order to allow the Amendment to go into effect no later than April 1, 2008.² The Commission established a February 15, 2008 comment date regarding the Amendment.³ In response, a number of parties submitted motions to intervene and comments, and one party, Citadel, also submitted a limited protest.⁴ A number of the parties state that they generally support the Amendment,⁵ but, as discussed below, they also propose changes and request clarification on certain issues. The CAISO addresses these parties' arguments below.

² The CAISO requested the same April 1, 2008 effective date in the Amendment.

³ The Commission did not establish a separate comment date regarding the CAISO's February 6, 2008 filing in this proceeding.

⁴ Motions to intervene were submitted by the following parties: the Alliance for Retail Markets; California Department of Water Resources State Water Project; California Municipal Utilities Association; Citadel Energy Products LLC, Citadel Energy Strategies LLC, and Citadel Energy Investments Ltd. (together, "Citadel"); Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside California ("Six Cities"); City of Santa Clara, California and the M-S-R Public Power Agency; Constellation Energy; Modesto Irrigation District; Northern California Power Agency ("NCPA"); Pacific Gas & Electric Company; Powerex Corp. ("Powerex"); Sacramento Municipal Utility District; Southern California Edison Company ("SCE"); Transmission Agency of Northern California ("TANC") and Western Area Power Administration. In addition, Citadel, CNCPA, Powerex, SCE, Six Cities, and TANC filed comments, and Citadel also filed a limited protest.

⁵ See Citadel at 5-6; NCPA at 3; Powerex at 5; SCE at 2-3; Six Cities at 4.

II. MOTION TO FILE ANSWER

The CAISO recognizes that, unless authorized by the Commission, the Commission's Rules of Practice and Procedures preclude an answer to protests. The CAISO hereby respectfully requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an Answer to Citadel's limited protest. 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.⁶

III. ANSWER

The CAISO greatly appreciates the involvement of Market Participants in the stakeholder process that led up to the filing of the Amendment and further appreciates expeditious response of intervenors to the CAISO's January 31, 2008 filing. The input provided by stakeholders was instrumental in fashioning the Amendment to more effectively meet their needs. Especially with the clarifications and refinements provided in this Answer, the Amendment will provide for the just and reasonable treatment of FTRs and CRRs in response to the delay in implementation of MRTU

A. There is No Overlap in Credit Requirements for Simultaneous Holdings of FTRs and CRRs.

Powerex states that the CAISO does not make clear the exact credit posting and payment timelines applicable to (i) its new FTR auction that will release FTRs

⁶ See, e.g., *Entergy Services, Inc.*, 116 FERC ¶ 61,286, at P 6 (2006); *Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,124, at P 11 (2006); *High Island Offshore System, L.L.C.*, 113 FERC ¶ 61,202, at P 8 (2005).

from April 1, 2008 through March 31, 2009 and (ii) its reduction in the terms of and resettlement of payments for currently released CRRs beginning April 1, 2008, up until the new MRTU implementation date. Powerex asserts that the CAISO does not specify how it will address any overlap in credit or payment requirements, and that this could result in Market Participants having to make duplicative credit postings for both FTRs and CRRs, only one of which will actually be in effect at any given time. Powerex argues that the CAISO should clarify further how it plans to coordinate the credit requirements for the reduction of CRRs that will be resettled and the release of new FTRs. Powerex also argues that the CAISO should clarify that a Market Participant that holds CRRs and that plans to purchase new FTRs should have to maintain the appropriate amount of credit for the larger of the two obligations, but not for both obligations. Since only one instrument will be in effect for any given time, Powerex states, duplicative credit requirements should be kept to a minimum.⁷

With respect to Powerex's concerns regarding credit posting and payment timelines for any FTR auction, such timelines are published in a Market Notice issued by the CAISO's FTR/CRR team in advance of each auction. The CAISO issued a Market Notice on February 14, 2008, requesting that parties post their collateral by close of business on March 7, 2008. Thus, Market Participants will have had ample advanced notice concerning credit posting and payment timelines with respect to any additional FTRs released for the period prior to the implementation of MRTU.

⁷ Powerex at 5-6.

As for Powerex's concern regarding duplicative FTR/CRR credit requirements, CRRs and FTRs are two completely different instruments and the CAISO must enforce the general tariff requirement that Market Participants have sufficient security, through a combination of an Unsecured Credit Limit and posted collateral, to cover their Estimated Aggregate Liability. The CAISO's creditworthiness requirements apply to the establishment of "credit limits for participation in any [CA]ISO auction of FTRs or CRRs and to CRR Holders for the holding of CRRs."⁸ Although candidate FTR Holders will be subject to the CAISO's credit requirements in order to bid on FTRs in the FTR auction process while also continuing to be subject to the CAISO's credit requirements for the CRRs that they hold, any collateral posted for the FTR auctions will be released once the FTR auction is settled, and there are no credit requirements for the holding of FTRs.

With respect to negatively valued CRRs, the CAISO does not believe that any offset in the credit requirements for the FTR auction should be given to CRR Holders because negatively valued CRRs are a financial obligation in and of themselves. Moreover, although only one instrument will be in effect for any given month, holders of negatively valued CRRs may have payment obligations even when MRTU is not in effect, until the resettlement of the CRR Auction is completed. During the months that MRTU is not in effect and CRRs are still outstanding, holders of CRRs will be subject to the unwinding as described in the Amendment filing and consequential associated charges for negatively valued CRRs. When MRTU is implemented, then the CRR Holder will be charged for counterflow congestion as appropriate.

⁸ CAISO Tariff, § 12.1.

Therefore, it is appropriate that the collateral requirements simultaneously cover both financial exposures. Nevertheless, with respect to credit requirements associated with holding CRRs, each CRR Holder's Estimated Aggregate Liability will be promptly adjusted as the CAISO unwinds those CRRs whose terms are reduced by the delay in MRTU implementation.

B. CRR Issues

1. The Priority Nomination Process for 2009 Is Outside the Scope of the Amendment and Issues Concerning It Will Be Addressed in a CAISO Stakeholder Process.

The Six Cities assert that the CRR Contingency Plan provides that if MRTU is not implemented prior to the time that a previously allocated or auctioned CRR would expire, then that CRR simply goes away. The Six Cities state that the CRR Contingency Plan is unclear as to the impact of this aspect of the plan on the ability of Market Participants to obtain CRRs in future years under the Priority Nomination Process. The Six Cities state that CRRs that were allocated for 2008 should continue to be recognized for purposes of the Priority Nomination Process for 2009 even if they are not effective in 2008 due to the delay in implementation of MRTU.⁹ NCPA raises the same issue, and states that it assumes that the failure to mention the Priority Nomination Process means that it is not affected by the Amendment, but requests confirmation that this is in fact the case.¹⁰

The CAISO recognizes that this is an important issue, but further analysis and discussion with stakeholders is needed before a determination is made as to the

⁹ Six Cities at 5-6.

¹⁰ NCPA at 3.

effect that the delay in MRTU implementation will have on the annual CRR Allocation process for 2009, including the Priority Nomination Process. Therefore, the CAISO will be vetting this issue in the stakeholder process about to commence regarding future releases of CRRs. Based on the outcome of that process, the CAISO will make a filing with the Commission by the end of May containing a proposal to address this issue.

2. In Response to Comments, the CAISO Proposes a Methodology for Assessing Interest on CRR Auction Resettlements that Ensures that the CAISO Has Neither a Deficit Nor a Surplus of Funds and also Addresses in Part Concerns Raised by Intervenors

In its limited protest, Citadel argues that the CAISO's proposal to pay or charge interest on CRR Auction resettlements beginning on the date a CRR would have been effective, absent a delay in MRTU implementation, is not just and reasonable. Citadel maintains that holders of prevailing flow CRRs (*i.e.*, CRRs that had positive CRR Auction prices) should receive interest commencing as of the date of the CRR Auction because they will have suffered a lost opportunity on resources locked up in CRRs that will never realize a return.¹¹ Furthermore, Citadel maintains that the CAISO's proposal provides an unwarranted benefit to holders of counterflow CRR positions (*i.e.*, CRRs that had negative CRR Auction prices) and to the CAISO, because they will have received interest free loans in exchange for contractual

¹¹ Citadel at 9-10.

obligations they were never required to perform due to the delay of MRTU implementation.¹²

The CAISO believes its proposal provides a just and reasonable approach to assessing interest on the CRR Auction resettlement. In developing a methodology to resettle the CRRs, the CAISO recognized that depending on how the resettlement is accomplished, the CAISO could be faced with either a shortfall or surplus of funds for which it must account. The CAISO further recognizes that in its proposal as originally filed, the CAISO will likely be left with a surplus of funds at the end of each month's CRR Auction resettlement, due to the fact that the time period for assessing interest on the resettlement amounts will be shorter than the time period during which the CAISO earned interest on the net CRR Auction revenues it holds. In reviewing Citadel's arguments, the CAISO also recognized that it is necessary to explain further how it will either collect for any shortfalls or allocate any surpluses. Below, the CAISO provides a description of the methodology it believes is most appropriate for the resettlement of the CRR Auction which ensures that the CAISO will not be subject to a funding shortfall as a result of the interest assessment and also prevents the CAISO from realizing a funding surplus. This methodology does not change the CAISO's proposal for resettlement of the CRRs themselves, but only provides a further mechanism for the interest calculation to ensure all surpluses and shortages are dispersed in a just and reasonable manner to CRR Auction participants rather than to other CAISO market participants.

¹² *Id.* at 9. Citadel also notes that the CAISO's interest proposal was not included in the December 13, 2007 version of the CRR Contingency Plan that was reviewed by stakeholders. The CAISO did, however, discuss its interest proposal with stakeholders on a conference call held on January 24, 2008, and also included it in a white paper distributed prior to that call.

The CAISO proposes that the amount of interest to be paid to each party that was awarded positive valued CRRs in the CRR Auction or to be charged to each party that was awarded negative valued CRRs should be determined so that (1) the same effective interest rate and interest period are applied to holders of positive valued CRRs and holders of negative valued CRRs, and (2) for each month for which the CRR Auction is resettled the CAISO will realize neither a shortfall nor a surplus of funds. The CAISO provides an example to illustrate how this approach would be applied.

Suppose that the CRR Auction for spring season, on-peak time-of-use results in net payments to the CAISO of \$1.2 million, which reflects \$1.5 million paid to the CAISO by parties who were awarded positive valued spring/on-peak CRRs and \$300,000 paid by the CAISO to parties who were awarded negative valued spring/on-peak CRRs. Suppose next that the CAISO allocates \$400,000 to the April 2008 CRR Balancing Account in accordance with MRTU Tariff Section 11.2.4. Finally, suppose that during the period from the original settlement date of the CRR Auction to the resettlement date for the month of April 2008 the CAISO earns \$36,000 in interest on the \$1.2 million it has been holding. Then, in calculating the April CRR Auction resettlement amounts, the CAISO will pay \$45,000 to parties who were awarded positive valued CRRs in addition to refunding the CRR Auction prices they paid, and will allocate the \$45,000 to such parties in proportion to the amount each party paid in the original CRR Auction settlement for spring/on-peak CRRs. Analogously, the CAISO will charge \$9,000 to parties who were awarded negative valued CRRs in addition to billing them for the CRR Auction prices they were paid,

and will allocate the \$9,000 to such parties in proportion to the amount each party was paid in the original CRR Auction settlement for spring/on-peak CRRs. The CAISO would then take the same approach for each month for which CRRs were auctioned and MRTU start-up is delayed.

By following the approach described above the CAISO will ensure that holders of positive valued CRRs and holders of negative valued CRRs are assessed the same interest rate over the same time period, and the CRR Balancing Account for each month that MRTU start-up is delayed ends up with neither a shortfall nor a surplus of funds.¹³

The CAISO recognizes that this methodology does not exactly address all of Citadel's concerns in that it does not – and in practical terms the CAISO cannot – ensure that parties who paid for positive valued CRRs in the auction are “made whole” for their cost of funds for the original CRR Auction settlement, or that parties who were paid for negative valued CRRs in the auction are prevented from realizing a gain on the amounts they were paid in the original CRR Auction settlement. Even assuming, *arguendo*, that making auction participants whole in Citadel's sense would be appropriate, it would be impossible for the CAISO to achieve such a result because the CAISO has no way of knowing each party's cost of funds or interest earnings.

¹³ By design, this approach does not reflect any particular choice of interest rate and interest time period. Indeed, given the objective of ending up with a net zero balance for the CAISO, there are infinite combinations of interest rates and interest periods that could yield the same result. It can be demonstrated algebraically that given the interest earned by the CAISO on the CRR Auction revenues it has held since the CRR Auction settlement, two of the three variables – the interest rate, the interest period, and the ending CAISO balance – can be chosen independently, but then the third variable would be determined. Thus it is possible to try to “tune” the interest rate and interest period to try to arrive at a zero ending balance for the CAISO, but the most reliable way to do this would be to make the ending balance one of the two choice variables and set it to zero.

Furthermore, Citadel's argument disregards the essential point, as emphasized by the CAISO in its transmittal letter accompanying the CRR Contingency Plan, namely that the CRR Auction occurred and was settled well in advance of the then-anticipated April 1, 2008 implementation date of MRTU. CRR Auction participants were fully aware of the time period between the CRR Auction settlement and the April 1 implementation date, and therefore the holders of positive valued CRRs had no expectation of any return on their investment until the terms of those CRRs were originally scheduled to commence. Likewise, it was understood that holders of negatively valued CRRs would have the benefit of the use of the revenues received as a result of purchasing counterflow positions until such time as the MRTU markets began operation. The economic impact of the time interval between the CRR Auction and the effectiveness of the CRRs should have been reflected in parties' bids for CRRs. For this reason, the CAISO argued it would be inappropriate to pay or charge interest on CRR resettlements so long as those settlements are invoiced by the beginning of the period on which those CRRs were originally scheduled to become effective. The CAISO will, of course, try to minimize these economic impacts of the delay of MRTU by resettling auctioned CRRs for all the remaining affected months as soon as the CAISO announces a new proposed effective date of MRTU.

The methodology described above and illustrated by the numerical example provides a mechanism to disperse any surpluses and shortages of funds that might result from a particular choice of interest rate and time period over which interest is assessed in the CRR Auction resettlement. It is important to recognize, however,

that if the methodology is not explicitly designed to ensure a zero ending balance for the CAISO, then the time period over which the CAISO assesses interest and the actual interest rate chosen will have different implications for whether the CAISO will have a surplus or shortage of funds in performing the CRR Auction resettlement. The CAISO offers the methodology described above precisely because it eliminates any such surplus or shortage, and does so in a way that treats holders of negatively and positively valued CRRs equally. Alternatively, if the Commission were to order the CAISO to adopt the Citadel approach to calculate interest back to the date of the original CRR Auction settlement and to use the FERC interest rate for such resettlement, the CAISO will definitely face a shortfall in funds due to the fact that it has earned a lower interest rate on the net CRR Auction revenues it has been holding. The Commission would therefore, as part of such an order, have to specify how the CAISO should recover that shortfall. The CAISO does not support such an approach because of the reasons stated in its transmittal letter and reiterated above. In particular, the CAISO believes it would not be appropriate to require other market participants who were not necessarily participants in the CRR Auction to be allocated a charge to recover a funding shortfall that resulted from resettling the CRR Auction. The CAISO's filed proposal – which would utilize the FERC interest rate and would calculate interest from the date the affected CRRs were to become effective – was designed to prevent any such shortfall.

The key aspects of the methodology described in the instant filing that make it attractive are that it recognizes Citadel's argument that it is not appropriate for the CAISO to realize a surplus of funds as a result of the CRR Auction settlement and

resettlement, and it provides an explicit method to disburse such surpluses. In addition, this methodology prevents such an outcome while still achieving the desirable properties of the proposal as filed, namely, equal treatment of holders of positive valued and negative valued CRRs, and minimizing risk of CAISO realizing a revenue shortfall as a result of the resettlement. The CAISO therefore requests that the Commission accept its proposed resettlement of the CRRs with this further refinement. The CAISO also recognizes this additional methodology would require additional tariff language and the CAISO will add conforming tariff language in any compliance filing directed by the Commission in its order on the CRR Contingency Plan Amendment.

C. FTR Issues

With regard to the FTR backstop measure proposed in the Amendment,¹⁴ SCE opposes the use of a proportional share of the 2007 FTR auction clearing prices for the FTR renewal periods. SCE asserts that the CAISO should instead apply the most recent FTR auction clearing prices from March 2008 for the renewal periods because March 2008 reflects the most recent market condition needs.¹⁵

The Commission should accept the FTR backstop measure contained in the Amendment. SCE provides no evidence that using prices based on a single month (March 2008) is preferable to using prices based on multiple months as proposed by the CAISO. Indeed, the CAISO submits that its approach is preferable to SCE's because it covers a longer time period and thus has less potential to result in prices

¹⁴ See CRR Contingency Plan Amendment, Transmittal Letter at 10-11.

¹⁵ SCE at 3.

that are skewed by seasonal differences in parties' preferred quantities and bids and the resulting prices for FTRs.

The CAISO also notes that although it still needs authority to implement the proposed backstop measures, the CAISO and Market Participants have made considerable strides towards implementing the FTR auction for 2008-2009, which would then obviate the need for the backstop. Indeed, on February 7, 2008 the CAISO posted its final FTR release amounts, seed prices and terms, and the 2008 FTR Bidder's Policy and Procedures Guide. On February 6, 2008, the CAISO also announced that it will be conducting the mock FTR auction on March 4 and 5, 2008. Participants are required to post their collateral on March 7, 2008, and the CAISO will conduct the actual FTR auction on March 11 through March 13, 2008.

SCE also contends that if MRTU is implemented prior to March 2009, the CAISO should refund to the FTR holders the settlement amounts, plus interest, based on the reduced terms of the FTRs proportionately. SCE asserts that the interest on such adjustments should run "from the FTR invoice due date to the FTR refund date and should be calculated at the FERC rate."¹⁶ Part of SCE's request is already contained in the CRR Contingency Plan Amendment. Namely, proposed Section 45.2 states that the CAISO shall "refund to the FTR Holders the Settlement amounts associated with the reduced terms of the FTRs proportionately." Additionally, the CAISO does not object to SCE's proposal to include interest on these amounts at the Commission's rate, with the caveat that the logic of Section 1.B.2 above – specifically that the CAISO should not realize a surplus of funds –

¹⁶ SCE at 3.

would be applicable here as well. Therefore the CAISO proposes that the same methodology described above for the resettlement of the CRR related amounts should apply here. Namely, the amount of interest to be paid to each party that was awarded FTRs should be determined so that for each month for which the FTR auction result is resettled the CAISO will realize neither a shortfall nor a surplus of funds. Therefore, the CAISO proposes that it would be appropriate to pay out the interest earned on all funds received from the FTR auction in proportion to the FTR holder's auction payments for its actual awarded FTRs. If the Commission accepts this addition to the CAISO's proposal, the CAISO will add conforming tariff language in any compliance filing directed by the Commission in its order on the CRR Contingency Plan Amendment.

Moreover, the CAISO wishes to clarify that, as part of its reversion plan, it does not intend to unwind any remaining FTR terms until after the first month of MRTU implementation, at which time reversion to its previous tariff is no longer an option. The purpose of maintaining this flexibility is to ensure that if the CAISO needs to revert from MRTU to its previously effective tariff that there are still FTRs in place. The CAISO believes that waiting at least one month to unwind any remaining FTRs is consistent with the proposed language of Section 45.2, which does not provide a specific timeframe for unwinding FTRs other than after the implementation of MRTU. Of course, as stated above, holders of FTRs subject to unwinding and refund will receive an amount attributable to the interest amounts the CAISO actually earned on the FTR funds.

TANC states that it appreciates that the CAISO recognizes that adjustments may be necessary to the historic quantity of FTRs and notes that one such adjustment involves Branch Group TRACYCOTP_BG. TANC states that certain capacity on this Branch Group is under contract for sale by the City of Vernon to TANC and that the CAISO should not include this capacity as available capacity in the 2008-2009 FTR auction.¹⁷ The CAISO recognizes that the capacity noted by TANC is under contract for sale by the City of Vernon and based on the calculation for release of FTR capacity the CAISO has determined that no capacity could be made available through the FTR auction. The CAISO will not include this capacity as available capacity in the 2008-2009 FTR auction.

The Six Cities state that, although the CRR Contingency Plan provides for extension of the FTR congestion management mechanism until the start-up date for MRTU, there is no explicit reference in the Amendment to the FTRs that the members of the Six Cities that are New Participating TOs are entitled to until the end of the Transition Period (December 31, 2010) under Section 36.4.3 of the currently effective CAISO Tariff. The Six Cities request that the CAISO be required to make explicit that the FTRs provided to New Participating TOs under Section 36.4.3 will be extended until the earlier of the start-up date for MRTU or the end of 2010.¹⁸ The CAISO confirms that the FTRs provided to New Participating TOs under Section 36.4.3 will be extended as the Six Cities state.

¹⁷ TANC at 6-7.

¹⁸ Six Cities at 4-5.

IV. CONCLUSION

For the reasons explained above, the Commission should accept the Amendment with the clarifications provided by the CAISO in this answer.

Respectfully submitted,

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Dated: March 3, 2008

CERTIFICATE OF SERVICE

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

Dated at Washington, D.C. this 3rd day of March, 2008.

/s/ Michael Kunselman
Michael Kunselman