SWIDLER BERLIN LLP

The Washington Harbour
3000 K Street, N.W., Suite 300
Washington, D.C. 20007-5116
Phone 202.424.7500
Fax 202.424.7647
www.swidlaw.com

February 14, 2005

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

Re: California Independent System Operator Corporation
Compliance Filing
Docket No. ER03-683-___

Dear Secretary Salas:

The California Independent System Operator Corporation ("ISO")[1] respectfully submits six copies of this filing in compliance with the Commission's January 6, 2005 order in the captioned docket, 110 FERC ¶ 61,007 ("January 6, 2005 Order").[2]

Payment of Start-Up Costs

In the January 6, 2005 Order, the Commission directed the ISO to modify its tariff to provide that, if a Generating Unit is instructed by the ISO to shut down to manage Intra-Zonal Congestion, and is subsequently re-started, the owner of that Generating Unit must have the opportunity to recover its Start-Up Costs. The Commission required this tariff modification to be made effective May 30, 2003. January 6, 2005 Order at P 20 and ordering paragraph (F).

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[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff. References to numbered sections herein are references to sections of the ISO Tariff unless otherwise indicated.

[2] On February 7, 2005, the ISO submitted a motion for extension of time, in which it requested an additional week, until February 14, to submit the present compliance filing. On February 7, 2005, the ISO also submitted a request for rehearing and motion for clarification, and motion for stay, in the captioned proceeding.

The ISO believes that the ISO Tariff currently provides generators with this opportunity, so that no further modifications are required to comply with this directive. Section 7.2.6.1 of the ISO Tariff provides in part as follows: "If a Generating Unit is instructed by the ISO to shut down to manage Intra-Zonal Congestion, and is subsequently re-started, the Owner of that Generating Unit may invoice the ISO for the Start-Up Costs incurred as set forth in Section 2.5.23.3.7.6." This sentence was added to Section 7.2.6.1 as part of the ISO's May 17, 2004 compliance filing in this docket, with a proposed effective date of May 30, 2003. Compliance Filing, Docket No. ER03-683-005 (filed May 17, 2004), Transmittal Letter at 4 and Attachments B and C ("May 17, 2004 Compliance Filing). No party protested that proposed tariff language. The January 6, 2005 Order did not note that the ISO had proposed such language in its May 17, 2004 Compliance Filing. In the present filing, the ISO is re-submitting the change to Section 7.2.6.1 that was contained in the May 17, 2004 Compliance Filing.

Standard Used by Potomac Economics for Determining Competitive Conditions

In the May 17, 2004 Compliance Filing, the ISO also included changes to Section 7.2.6.1.1(a)(1) of the ISO Tariff containing the interpretation of Potomac Economics ("Potomac"), the independent entity responsible for determining reference prices, regarding when "competitive periods" exist for purposes of the ISO's application of Section 7.2.6.1.1. The Commission stated in the January 6, 2005 Order that the changes will not become effective until the ISO submits them in a filing pursuant to Section 205 of the Federal Power Act and the Commission accepts that Section 205 filing. January 6, 2005 Order at P 31. Therefore, in the present compliance filing, the ISO has deleted those changes from Section 7.2.6.1.1(a)(1). However, on February 7, 2005, the ISO filed a Request for Rehearing ("Rehearing Filing") of the January 6, 2005 Order. In its Rehearing Filing, the ISO argued that the tariff language being deleted herein was appropriately included in the May 17, 2004 Compliance Filing (assuming *arguendo* that such language is even required to be in the tariff – which the ISO submits, consistent with prior Commission orders, it is not) and should be effective January 20, 2004. The ISO also noted that it was inconsistent for the Commission to allow tariff language regarding start-up cost recovery to be effective May 30, 2003, but to require the ISO to make a Section 205 filing to implement tariff language regarding Potomac's interpretation of tariff language that was previously approved in this proceeding, especially given that such tariff language was filed along with the start-up cost recovery tariff language in the May 17, 2004 Compliance Filing. In any event, the changes reflected in the

instant Compliance Filing are without prejudice to the ISO's pending Rehearing Filing.

Use of a Daily Gas Index in Calculating Decremental Reference Levels

The Commission directed the ISO to incorporate the use of a Commission-approved daily gas index into the calculation of decremental reference levels. January 6, 2005 Order at P 41 and ordering paragraph (F). To comply with this directive, the ISO proposes to use the same daily gas price index as is used to set the price for Reliability Must-Run ("RMR") Units. This is the same approach that the Commission approved in the proceeding concerning Amendment No. 60 to the ISO Tariff ("Amendment No. 60"). In that proceeding, the Commission approved the ISO's proposal to use "the same daily gas price index as the RMR units to calculate start-up and minimum costs." *California Independent System Operator Corporation*, 108 FERC ¶ 61,022, at P 81 (2004). *See also* Amendment No. 60, Docket No. ER04-835-000 (filed May 11, 2004), at pages 25-26 of Transmittal Letter, and pages 4, 9, and 16 of Attachment B2 (containing tariff language that refers to "Equation C1-8 (Gas) of the Schedules to the Reliability Must-Run Contract for the relevant Service Area (San Diego Gas & Electric Company, Southern California Gas Company, or Pacific Gas and Electric Company), or, if the Must-Offer Generator is not served from one of those three Service Areas, from the nearest of those three Service Areas").[3]

In the present filing, the ISO proposes language to implement the daily gas index that is similar to the language approved in the Amendment No. 60 proceeding. Thus, the ISO is proposing use of a "Commission-approved daily gas index." Specifically, the ISO proposes to modify Section 7.2.6.1.1(a)(1) of the ISO Tariff so that the language in the section referring to adjustments for "monthly changes in fuel prices using the proxy figure for natural gas prices posted on the ISO Home Page," becomes language referring to adjustments for "daily changes in fuel prices using the gas price determined by Equation C1-8 (Gas) of the Schedules to the Reliability Must-Run Contract for the relevant Service Area (San Diego Gas & Electric Company, Southern California Edison Company, or Pacific Gas and Electric Company), or, if the resource is not served from one of those three Service Areas, from the nearest of those three Service

[3] In the present proceeding, the Commission stated that it believes the use of a daily gas index is reasonable because "it meets the standards put forth in the Commission's Policy Statement on Natural Gas and Electric Markets." January 6, 2005 Order at P 41. Likewise, in the Amendment No. 60 proceeding, the Commission found the ISO's proposal to use same daily gas index as is used to set the price for RMR Units because "it meets the standards put forth in the Commission's Policy Statement on Natural Gas and Electric Markets." *California Independent System Operator Corporation*, 108 FERC at P 81.

Areas." The ISO also proposes to modify Sections 7.2.6.1.1(a)(3) and 7.2.6.1.1(a)(4) to reference the changes to Section 7.2.6.1.1(a)(1) concerning the daily gas index.

The ISO notes that use of Equation C1-8 always involves a lag between when the gas price used in the daily gas index is determined and when the daily gas index based on that gas price can be calculated. The lag cannot be eliminated without modifying the calculation methodology in Equation C1-8. The lag involved in the use of Equation C1-8 can be as much as six days. For the sake of simplicity, the ISO proposes to use Equation C1-8 with a six-day lag to calculate decremental reference levels for the following Trading Day. The ISO proposes to describe the six-day lag in Section 7.2.6.1.1(a)(1).

As an illustration of the timeline that will apply for determining the decremental reference prices based on the daily gas index for a particular date, here is the timeline that will apply for determining decremental reference prices, based on the daily gas index, for use on Trading Day May 20, 2005:

1. The gas price to be used in the daily gas index will be determined on May 13, 2005.

2. Six days later, on May 19, 2005, the daily gas index for May 13, will be calculated by the ISO using Equation C1-8. The ISO will transmit the daily gas index for May 13 to Potomac, so that Potomac can determine the decremental reference prices based on the daily gas index.

3. Potomac will determine the decremental reference prices – based on the daily gas index for May 13 – for use on the following Trading Day, May 20, 2005, and will transmit the decremental reference prices to the ISO.[4]

In addition, the decremental reference prices based on the daily gas index can only be determined on a prospective basis. In that regard, it will be necessary for the ISO and Potomac to make changes to their software in order to implement the use of the daily gas index described above. Potomac has estimated that it will take 2-2.5 months to deploy the changes required by the January 6, 2005 Order. Thus, the ISO expects that the necessary software

[4] If the May 13, 2005 daily gas index were not available for any reason, Potomac would use the most recent daily gas index value that Potomac had in its possession. This would most likely be the daily gas index value for May 12, 2005.

changes will be completed by April 29, 2005. After the software changes are made, the ISO will implement the use of the daily gas index. Therefore, the ISO proposes to make the use of the daily gas index effective one day after providing notice to the market; the ISO anticipates that it will provide the required notice to the market by April 29, 2005.

Materials Included in the Present Compliance Filing

The tariff changes described above are shown in the revised sheets provided in Attachment A to the present filing, and are shown in black-line format in Attachment B to the present filing. Additionally, the ISO submits, in Attachment C to the present filing, a form notice of filing suitable for publication in the Federal Register, along with a computer diskette containing the notice of filing.

Two additional copies of this filing are enclosed to be date-stamped and returned to our messenger. If there are questions concerning this filing, please contact the undersigned.

Respectfully submitted,

Bradley R. Miliauskas

Anthony J. Ivancovich
Associate General Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-4400
Fax: (916) 608-7287

Kenneth G. Jaffe
Bradley R. Miliauskas
Swidler Berlin LLP
3000 K Street, NW, Suite 300
Washington, DC 20007
Tel: (202) 424-7500
Fax: (202) 424-7643

ATTACHMENT A

7.2.6.1 Decremental Bids. With regard to decremental bids, if Final Hour-Ahead Schedules cause Congestion on the Intra-Zonal interface, the ISO shall, after Dispatching available and effective Reliability Must-Run Units to manage the Congestion, apply the decremental reference prices determined by the independent entity that determines the reference prices for the Automatic Mitigation Procedure (AMP) as described in Appendix A to the Market Monitoring and Information Protocol. The ISO shall Dispatch Generating Units according to the decremental reference prices thus established, the resource's effectiveness on the Congestion, and other relevant factors such as Energy limitations, existing contractual restrictions, and Regulatory Must-Run or Regulatory Must-Take status, to alleviate the Congestion after Final Hour-Ahead Schedules are issued. Where the ISO must reduce a Generating Unit's output, the ISO shall Dispatch Generating Units according to the decremental reference prices and not according to Adjustment Bids or Supplemental Energy Bids to alleviate Intra-Zonal Congestion. No Generating Unit shall be Dispatched below its minimum operating level or above its maximum operating level. No Reliability Must-Run Unit shall be Dispatched below the operating level determined by the ISO as necessary to maintain reliability. If Congestion still exists after all Generating Units are Dispatched to their minimum operating levels, the ISO shall instruct Generating Units to shut off in merit order based on their decremental reference prices at minimum load, beginning with the most expensive unit.

The ISO shall apply the decremental reference prices to themal Generating Units and to non-thermal Generating Units. If a Generating Unit is instructed by the ISO to shut down to manage Intra-Zonal Congestion, and is subsequently re-started, the Owner of that Generating Unit may invoice the ISO for the Start-Up Costs incurred as set forth in Section 2.5.23.3.7.6.

If the ISO Dispatches System Resources or Dispatchable Loads to alleviate Intra-Zonal Congestion, the ISO shall Dispatch those resources in merit order according to the resource's Day-Ahead or Hour-Ahead Adjustment Bid or Imbalance Energy bid.

The ISO shall only redispatch Regulatory Must-Take or Regulatory Must-Run Generation,

Intermittent Resources, or Qualifying Facilities to manage Intra-Zonal Congestion after redispatching all other available and effective generating resources, including Reliability Must-Run Units.

7.2.6.1.1 Decremental Bid Reference Levels. Decremental bid reference levels shall be determined for use in managing Intra-Zonal Congestion as set forth above in Section 7.2.6.1.

(a) Determination. Decremental bid reference levels shall be determined by applying the following steps in order as needed:

1. Excluding proxy bids, mitigated bids, and bids used out of merit order for managing Intra-Zonal Congestion, the accepted decremental bid, or the lower of the mean or the median of a resource's accepted decremental bids if such a resource has more than one accepted decremental bid in competitive periods over the previous 90 days for peak and off-peak periods, adjusted for daily changes in fuel prices using the gas price determined by Equation C1-8 (Gas) of the Schedules to the Reliability Must-Run Contract for the relevant Service Area (San Diego Gas & Electric Company, Southern California Edison Company, or Pacific Gas and Electric Company), or, if the resource is not served from one of those three Service Areas, from the nearest of those three Service Areas. There will be a six-day time lag between when the gas price used in the daily gas index is determined and when the daily gas index based on that gas price can be calculated. Accepted and justified decremental bids below the applicable

soft cap, as set forth in Section 28.1.3 of this Tariff, will be included in the calculation of reference prices;

2. A level determined in consultation with the Market Participant submitting the bid or bids at issue, provided such consultation has occurred prior to the occurrence of the conduct being examined, and provided the Market Participant has provided sufficient data in accordance with specifications provided by the independent entity responsible for determining reference prices;
3. 90 percent of the unit's default Energy Bid determined monthly as set forth in Section 5.11.5 (based on the incremental heat rate submitted to the independent entity responsible for determining reference prices, adjusted for gas prices determined according to paragraph (a)(1) above, and the variable O&M cost on file with the independent entity responsible for determining reference prices, or the default O&M cost of $6/MWh);
4. 90 percent of the mean of the economic Market Clearing Prices for the units' relevant location during the lowest-priced 25 percent of the hours that the unit was dispatched or scheduled over the previous 90 days for peak and off-peak periods, adjusted for changes in fuel prices determined according to paragraph (a)(1) above; or
5. If sufficient data do not exist to calculate a reference level on the basis of the first, second, or fourth methods and the third method is not applicable or an attempt to determine a reference level in consultation with a Market Participant has not been successful, the independent entity responsible for determining reference prices shall determine a reference level on the basis of:

    i. the independent entity's estimated costs of an electric facility, taking into account available operating costs data, opportunity

ATTACHMENT B

7.2.6.1 Intra-Zonal Congestion Management. With regard to decremental bids, if Final Hour-Ahead Schedules cause Congestion on the Intra-Zonal interface, the ISO shall, after Dispatching available and effective Reliability Must-Run Units to manage the Congestion, apply the decremental reference prices determined by the independent entity that determines the reference prices for the Automatic Mitigation Procedure (AMP) as described in Appendix A to the Market Monitoring and Information Protocol. The ISO shall Dispatch Generating Units according to the decremental reference prices thus established, the resource's effectiveness on the Congestion, and other relevant factors such as Energy limitations, existing contractual restrictions, and Regulatory Must-Run or Regulatory Must-Take status, to alleviate the Congestion after Final Hour-Ahead Schedules are issued. Where the ISO must reduce a Generating Unit's output, the ISO shall Dispatch Generating Units according to the decremental reference prices and not according to Adjustment Bids or Supplemental Energy Bids to alleviate Intra-Zonal Congestion. No Generating Unit shall be Dispatched below its minimum operating level or above its maximum operating level. No Reliability Must-Run Unit shall be Dispatched below the operating level determined by the ISO as necessary to maintain reliability. If Congestion still exists after all Generating Units are Dispatched to their minimum operating levels, the ISO shall instruct Generating Units to shut off in merit order based on their decremental reference prices at minimum load, beginning with the most expensive unit.

The ISO shall apply the decremental reference prices to thermal Generating Units and to non-thermal Generating Units. If a Generating Unit is instructed by the ISO to shut down to manage Intra-Zonal Congestion, and is subsequently re-started, the Owner of that Generating Unit may invoice the ISO for the Start-Up Costs incurred as set forth in Section 2.5.23.3.7.6.

If the ISO Dispatches System Resources or Dispatchable Loads to alleviate Intra-Zonal Congestion, the ISO shall Dispatch those resources in merit order according to the resource's Day-Ahead or Hour-Ahead Adjustment Bid or Imbalance Energy bid.

The ISO shall only redispatch Regulatory Must-Take or Regulatory Must-Run Generation, *Intermittent Resources, or Qualifying Facilities to manage Intra-Zonal Congestion after* redispatching all other available and effective generating resources, including Reliability Must-Run Units.

* * *

7.2.6.1.1 Decremental Bid Reference Levels. Decremental bid reference levels shall be determined for use in managing Intra-Zonal Congestion as set forth above in Section 7.2.6.1.

(a) Determination. Decremental bid reference levels shall be determined by applying the following steps in order as needed:

1. Excluding proxy bids, mitigated bids, and bids used out of merit order for managing Intra-Zonal Congestion, the accepted decremental bid, or the lower of the mean or the median of a resource's accepted decremental bids if such a resource has more than one accepted decremental bid in competitive periods over the previous 90 days for peak and off-peak periods, adjusted for ~~monthly~~daily changes in fuel prices using the ~~proxy figure for natural gas prices posted on the ISO Home Page~~gas price determined by Equation C1-8 (Gas) of the Schedules to the Reliability Must-Run Contract for the relevant Service Area (San Diego Gas & Electric Company, Southern California Edison Company, or Pacific Gas and Electric Company), or, if the resource is not served from one of those three Service Areas, from the nearest of those three Service Areas. There will be a six-day time lag between when the gas price used in the daily gas index is determined and when the daily gas index based on that gas price can be calculated.~~For the purposes of this Section 7.2.6.1.1, to determine whether accepted decremental bids over the previous 90 days were accepted during competitive periods, the independent entity responsible for determining reference prices will apply a test to the prior 90-day period. The test will require that the ratio of a unit's accepted out-of-sequence decremental bids (MWh) for the prior 90 days to its total accepted decremental bids (MWh) for the prior 90 days be less than 50 percent. If this ratio is greater or equal to 50%, accepted decremental bids will be determined to have been accepted in non-competitive periods and cannot be used to determine the

~~decremental reference price. This test would be applied each day on a rolling 90-day basis. One ratio would be calculated for each unit with no differentiation for various output segments on the unit.~~ Accepted and justified decremental bids below the applicable soft cap, as set forth in Section 28.1.3 of this Tariff, will be included in the calculation of reference prices;

2. A level determined in consultation with the Market Participant submitting the bid or bids at issue, provided such consultation has occurred prior to the occurrence of the conduct being examined, and provided the Market Participant has provided sufficient data in accordance with specifications provided by the independent entity responsible for determining reference prices;
3. 90 percent of the unit's default Energy Bid determined monthly as set forth in Section 5.11.5 (based on the incremental heat rate submitted to the independent entity responsible for determining reference prices, adjusted for gas prices determined according to paragraph (a)(1) above, and the variable O&M cost on file with the independent entity responsible for determining reference prices, or the default O&M cost of $6/MWh);
4. 90 percent of the mean of the economic Market Clearing Prices for the units' relevant location during the lowest-priced 25 percent of the hours that the unit was dispatched or scheduled over the previous 90 days for peak and off-peak periods, adjusted for changes in fuel prices determined according to paragraph (a)(1) above; or
5. If sufficient data do not exist to calculate a reference level on the basis of the first, second, or fourth methods and the third method is not applicable or an attempt to determine a reference level in consultation with a Market Participant has not been successful, the independent entity responsible for

determining reference prices shall determine a reference level on the basis of:

i. the independent entity's estimated costs of an electric facility, taking into account available operating costs data, opportunity cost, and appropriate input from the Market Participant, and the best information available to the independent entity; or

ii. an appropriate average of competitive bids of one or more similar electric Facilities.

(b) Monotonicity.

The decremental bid reference levels ($/MWh bid price) for the different bid segments of each resource shall be made monotonically non-decreasing by the independent entity responsible for determining reference prices by proceeding from the highest MW bid segment moving through each lower MW bid segment. The reference level of each succeeding bid segment, moving from right to left in order of decreasing operating level, shall be the lower of the reference level of the preceding bid segment or the reference level determined according to paragraph (a) above.

ATTACHMENT C

NOTICE OF FILING SUITABLE FOR PUBLICATION IN THE FEDERAL REGISTER

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket No. ER03-683-___**

Notice of Filing

[ ]

Take notice that on February 14, 2005, the California Independent System Operator Corporation (ISO) submitted a filing in compliance with the Commission's January 6, 2005 order in the captioned docket, 110 FERC ¶ 61,007.

The ISO states that this filing has been served upon all parties on the official service list for the captioned docket. In addition, the ISO has posted this filing on the ISO Home Page.

Any person desiring to intervene or to protest this filing should file with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211 and 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a motion to intervene. All such motions or protests should be filed on or before the comment date, and, to the extent applicable, must be served on the applicant and on any other person designated on the official service list. This filing is available for review at the Commission or may be viewed on the Commission's web site at http://www.ferc.gov, using the **eLibrary** (FERRIS) link. Enter the docket number excluding the last three digits in the docket number field to access the document. For assistance, please contact FERC Online Support at FERCOnlineSupport@ferc.gov or toll-free at (866)208-3676, or for TTY, contact (202)502-8659. Protests and interventions may be filed electronically via the Internet in lieu of paper; see 18 CFR 385.2001(a)(1)(iii) and the instructions on the Commission's web site under the "e-Filing" link. The Commission strongly encourages electronic filings.

Comment Date: _____