UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)**	**Docket No. ER12-423-000**

ANSWER TO MOTIONS TO INTERVENE AND COMMENTS, MOTION TO FILE ANSWER, AND ANSWER TO LIMITED PROTEST, OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

The California Independent System Operator Corporation ("ISO")[1] hereby files its answer to the motions to intervene and comments submitted in this proceeding in response to the ISO's submittal on November 16, 2011 of an amendment to the ISO tariff to enhance the overall accuracy and efficiency of the ISO's local market power mitigation ("LMPM") process.[2] The ISO also hereby submits a motion to file an answer and its answer to the limited protest submitted in this proceeding by WPTF.[3] The comments and limited protest submitted in

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[1] The ISO is also sometimes referred to as the CAISO. Capitalized terms not otherwise defined herein have the meanings set forth in Appendix A to the ISO tariff, as revised by the proposed tariff changes contained in the ISO's November 16, 2011 tariff amendment in this proceeding. Except where otherwise specified, references in this answer to section numbers are references to sections of the ISO tariff as revised by the proposals in the tariff amendment.

[2] The following entities filed motions to intervene and/or comments in this proceeding: the California Department of Water Resources State Water Project ("SWP"); Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California; City of Santa Clara, California and the M-S-R Public Power Agency; Modesto Irrigation District; Northern California Power Agency; NRG Power Marketing LLC, Cabrillo Power I LLC, Cabrillo Power II LLC, El Segundo Power LLC, Long Beach Generation LLC, and NRG Solar Blythe LLC; Pacific Gas and Electric Company; Southern California Edison Company ("SCE"); and Western Power Trading Forum ("WPTF").

[3] The ISO submits this answer pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213. The ISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to the 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 the case. *See, e.g.*, *Xcel Energy Services, Inc.*, 124 FERC ¶ 61,011, at P 20 (2008); *California Independent*

this proceeding largely express support for the November 16 tariff amendment.[4] However, the comments and limited protest also suggest that the tariff amendment should be modified in some respects or that the ISO should be subject to reporting obligations in addition to those that it has already agreed to assume. For the reasons explained below, the Commission should accept the tariff amendment as filed and should not impose any reporting obligations on the ISO in this proceeding or otherwise conditions its acceptance of this tariff amendment.

The ISO filed the November 16 tariff amendment in order to: (1) comply with the Commission's directive in its September 2006 order to use bid-in rather than forecast demand in the LMPM process in the day-ahead market within three years of implementation of the ISO's nodal market design; (2) improve the LMPM process; and (3) add a new dynamic process for determining whether a transmission path is competitive or non-competitive as part of the day-ahead LMPM process. Pursuant to the November 16 tariff amendment, the ISO proposes to implement the first stage of the LMPM revisions ("LMPM Stage One") for the April 11, 2012 trading day. The ISO also plans to submit a future

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System Operator Corp., 132 FERC ¶ 61,023, at P 16 (2010); *Equitrans, L.P.*, 134 FERC ¶ 61,250, at P 6 (2011).

[4] *See* SCE at 2 ("SCE supports the ISO's direction as stated in this proposal. Based on the ISO's representation, the proposed amendments should lead to a more accurate mitigation and competitive path determination process."); WPTF at 4 ("The CAISO's proposed approach offers a remedy to several local market power mitigation deficiencies that have existed since the design of MRTU [the Market Redesign and Technology Upgrade, also known as the new CAISO market]. As such, WPTF supports the fundamentals of the proposed design changes as previously indicated in our comments below.").

tariff amendment to implement the second stage ("LMPM Stage Two"), with an anticipated effective date in the fourth quarter of 2012.

I. Answer

A. The ISO's Continued Use of a Zero Threshold Value Is Just and Reasonable

WPTF argues that the ISO fails to justify using a threshold value of zero for the non-competitive component of congestion.[5] The ISO does not bear the burden of justifying that a zero threshold value for mitigation is just and reasonable in the context of the November 16 amendment. The ISO's current LMPM process utilizes a zero threshold for mitigation. Thus, by continuing to use a zero threshold value in its revised LMPM process, the ISO is simply maintaining the same zero threshold value that is present in the existing tariff. The Commission has already found the existing tariff – which includes a zero threshold value – to be just and reasonable. Therefore, the ISO has no obligation to further demonstrate that the use of a zero threshold value in the LMPM process is just and reasonable.

WPTF suggests implementing an initial threshold value of $1/MWh.[6] WPTF does not explain why it proposes a $1/MWh threshold other than that it is the smallest positive integer value for the threshold and WPTF "believes this small value to be conservative but still large enough to ensure that mitigation is

[5] WPTF at 12-14.

[6] WPTF at 14-15.

not applied unnecessarily."[7] However, WPTF provides no support for its assertion that the lack of a threshold will result in "unnecessary mitigation," or that a $1/MWh threshold would appropriately address any "unnecessary mitigation." By design, the ISO's new LMPM method with a threshold value of zero will eliminate instances of over-mitigation that are not due to congestion on a non-competitive constraint. Also, under the ISO's new LMPM method, a resource with small positive LMP non-competitive component and thus subject to mitigation will be mitigated only to the extent that is bounded by the small positive LMP non-competitive component. Therefore, there is no basis for WPTF's concern about "unnecessary mitigation" on resources with small positive LMP non-competitive components. In addition, adopting a non-zero threshold value may impact the frequency of mitigation in terms of the number of units mitigated. This mitigation frequency directly affects the implementation of the frequently mitigated unit (FMU) provisions of the ISO's tariff, which allows units that are "frequently mitigated" to receive an adder to their default energy bids. The determination as to whether a unit is considered frequently mitigated is based on an annual assessment of the frequency of both day-ahead and real-time mitigation. It would be premature to adopt a non-zero threshold value before the the ISO has had an opportunity to evaluate the impact that such a threshold value would have on the operation of the FMU provisions of its tariff.

[7] *Id.*

WPTF argues that the CAISO fails to justify why a three-month historic sample demonstrates the effectiveness of its staged LMPM proposal yet a six-month prospective analysis is needed to establish a non-zero threshold value.[8] As explained in the November 16 tariff amendment, the ISO has committed to analyzing market mitigation data under its new LMPM process in order to make an informed judgment as to whether adopting some level of mitigation threshold would be appropriate, and if so, to what level the threshold should be set. The ISO plans to revisit this issue after evaluating six months of actual market data under the revised LMPM process with a dynamic competitive path assessment process, which will be implemented first in the day-ahead market and later in the real-time market. It is not possible for the ISO to determine precisely the result of the application of the dynamic competitive path analysis to historic transactions. For these reasons, it would be premature and unwarranted to propose a threshold value that replaces the existing zero value until the ISO's analysis on this issue is completed.

WPTF also asserts that, in any event, the threshold value for LMPM Stage One should be applied in LMPM Stage Two unless the ISO justifies a different Stage Two value.[9] As the ISO explained in the November 16 filing, in order for this assessment to be meaningful, it will need to analyze the actual operation of the LMP decomposition method in conjunction with the dynamic competitive path assessment for both the day-ahead and real-time markets. WPTF appears to be proposing that if the ISO determines that a non-zero mitigation threshold is

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[9] *Id.* at 14.

appropriate for the day-ahead market, that such value should be automatically applied to the real-time market without waiting for any assessment as to whether such a threshold is actually necessary. The ISO urges the Commission to reject this suggestion. The day-ahead and real-time are separate markets with separate time frames, rules, and mechanisms. The results of an analysis of the operation of the revised LMPM process in the day-ahead is therefore unlikely to provide any meaningful guidance as to what, if any, mitigation threshold would be appropriate for the real-time market. As a result, it would be inappropriate to use the results of the analysis of mitigation in the day-ahead market for this purpose.

B. The ISO's Proposed Definition of a Net Seller and its Continued Use of a Three Pivotal Supplier Test Are Just and Reasonable

SCE argues that the ISO's proposed definition of a net seller in Section 39.7.2.2(a)(vi) of the ISO tariff may undermine the integrity of the three pivotal supplier test included in Section 39.7.2.2(a). SCE contends that the ISO should modify the definition of a net seller from what SCE characterizes as an "annual determination" of net seller behavior to a monthly determination of such behavior – specifically, that the determination should be performed by having a mid-month look-back at the prior month.[10]

The Commission should decline to adopt SCE's proposed modifications. SCE's characterization of the ISO's look-back process as an "annual determination" is misleading. In fact, the ISO will update its determination of net seller behavior every three months, not every 12 months. As set forth in Section

[10] SCE at 4-5.

39.7.2.2(vi), "[t]he ISO will calculate whether portfolios are portfolios of net buyers [*i.e.*, are not portfolios of net sellers] in the third month of each calendar quarter and the calculations will go into effect at the start of the next calendar quarter. The twelve (12) month period used in this calculation will be the most recent twelve month period for which data is available."

As Section 39.7.1.2.2(vi) indicates, the ISO's quarterly assessment examines portfolios based on twelve months of data. This twelve-month look-back period is appropriate because it provides the ISO with a sufficiently large sample of market participant behavior to determine whether the market participant is more appropriately treated as a net seller or net buyer and allows outlier amounts of purchases and sales to be balanced out over the course of the twelve month period. The intent of this provision is to accurately determine the general nature of a participant's position in the wholesale market. Inherently, a market participant who controls a generation asset has a business model that is centered on minimizing the cost to serve its load or maximize profit of providing energy. This characteristic is not dynamic. The provision was intended to capture this inherent relationship to the wholesale electricity market and, by extension, the incentive to exercise local market power to increase the spot price and further increase profits. The determination of a net seller pursuant to the November 16 tariff amendment covers a sufficiently long period of time to insure that the resulting designation reflects the market participant's structural relationship with the wholesale electricity market.

By comparison, SCE's proposed monthly determination would provide a much more truncated snapshot of market participant behavior, thereby creating a risk that a market participant that is, on average, a net buyer or net seller, might be treated as the opposite because of an anomalous month, and thereby reducing the accuracy of the ISO's competitive path assessment. One significant risk with a shorter-term calculation is that a large load serving entity could be treated as a net seller in one month based on a short-term historical position that was out of line with its more general position in the market. This could result in removing a very large portion of generation during the pivotal supplier test which would increase the likelihood that a constraint will be deemed uncompetitive, that mitigation will be applied, and that prices will be lowered as a result. This may in fact benefit the large load serving entity by lowering spot prices as well as potentially lowering the price basis for forward contracting in instances where the ISO would not expect the load serving entity to exercise local market power in order to increase spot prices in the first place. This would be a misapplication of mitigation and would result in inaccurate pricing. The use of twelve months of data makes it much less likely that a large load serving entity will be considered to be a net seller. For these reason, the ISO's twelve-month look-back period is more appropriate, especially given the fact that the net seller assessment will be updated every calendar quarter.

Moreover, the proper legal standard is whether the *ISO's* proposal is just and reasonable under Section 205 of the Federal Power Act ("FPA").[11]

[11] 16 U.S.C. § 824d. Under Section 15 of the CAISO tariff, the ISO is the entity authorized to submit filings for Commission approval pursuant to Section 205 of the FPA.

Specifically, as the Commission has explained, "the courts and this Commission have recognized that there is not a single just and reasonable rate. Instead, we evaluate [proposals under Section 205] to determine whether they fall into a zone of reasonableness. So long as the end result is just and reasonable, the [proposal] will satisfy the statutory standard."[12] The ISO's proposed look-back period falls well within the zone of reasonableness, because it will produce accurate results of net seller behavior as discussed above. Therefore, the Commission should not require the ISO to modify its three pivotal supplier test as requested by SCE.

WPTF argues that the Commission has expressed concern that the ISO's three pivotal supplier test may be overly conservative, and therefore that the ISO should file an analysis of the appropriateness of continuing to use a three pivotal supplier test.[13] WPTF fails to provide any support for its argument. To the contrary, in the September 2006 order authorizing ISO tariff provisions to implement the new market, the Commission expressly found that "the three-pivotal-supplier test is reasonable."[14] The Commission also directed the ISO's Market Surveillance Committee, "during the first year of implementation [of the new market], to examine whether an alternative competitive screen to identify

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[12] *Calpine Corp. v. California Independent System Operator Corp.*, 128 FERC ¶ 61,271, at P 41 (2009) (citations omitted). *See also New England Power Co.*, 52 FERC ¶ 61,090, at 61,336 (1990), *aff'd*, *Town of Norwood v. FERC*, 962 F.2d 20 (D.C. Cir. 1992) (rate design proposed need not be perfect, it merely needs to be just and reasonable), *citing Cities of Bethany, et al. v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984) (utility needs to establish that its proposed rate design is reasonable, not that it is superior to all alternatives).

[13] WPTF at 15-16.

[14] *California Independent System Operator Corp.*, 116 FERC ¶ 61,274, at P 1032 (2006).

market power opportunities for generation in load pockets should be considered."[15] The new ISO market went into effect in April 2009. In June 2010, the ISO filed a report prepared by the Market Surveillance Committee to satisfy the Commission's directive. The Market Surveillance Committee report concluded that no changes to the LMPM mechanism were needed at that time,[16] and the Market Surveillance Committee has not subsequently stated that the three pivotal supplier test should be revised. Therefore, there is no basis for questioning the continued justness and reasonableness of the three pivotal supplier test.

Moreover, the Market Surveillance Committee and the Department of Market Monitoring will be monitoring the operation and effectiveness of the revised LMPM process after it is implemented. If, based on their monitoring, either of those entities determines that the three pivotal supplier test may need to be revised, they will say so in a report that will be provided to the Commission.

C. The ISO's Proposed Affiliate Reporting Provisions Are Just and Reasonable

SCE asserts that affiliate transaction rules issued by the California Public Utilities Commission ("CPUC") prohibit utilities from providing non-public information to their affiliates, and that the amount of electricity for which SCE has contracted with its resources, and the identities of the resources with which SCE

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[15] *Id.*

[16] Report on the Performance of the California ISO's Local Market Power Mitigation Mechanism During the First Year, Docket No. ER06-615-000, at 32 (June 7, 2010).

has power purchase agreements, may be non-public information subject to those CPUC rules. SCE argues that proposed Sections 4.5.1.1.13 and 4.5.1.2.1.1 of the CAISO tariff would require SCE's affiliates to obtain such non-public information from SCE in order to register it with the CAISO, in violation of the CPUC's affiliate transaction rules.[17]

SCE misunderstands how Sections 4.5.1.1.13 and 4.5.1.2.1.1 will operate. By its express terms, Section 4.5.1.1.13 will require each scheduling coordinator applicant to register with the CAISO any resource that the scheduling coordinator applicant controls through a resource control agreement to which the scheduling coordinator applicant and/or any affiliate that satisfies the criteria set forth in proposed Section 4.5.1.1.12 is a party. A scheduling coordinator applicant that controls a resource through a resource control agreement (regardless of whether the scheduling coordinator applicant itself or an affiliate is a party to the agreement) will know that it exercises such control over the resource, without having to provide any information to an affiliate. Thus, Section 4.5.1.1.13 does not require a scheduling coordinator applicant to provide any information – public or non-public – to an affiliate in violation of the CPUC affiliate transaction rules.

Section 4.5.1.2.1.1 will require each scheduling coordinator to fulfill an ongoing obligation to inform the CAISO of any changes submitted by it to the CAISO as part of the application process, including any changes regarding resources controlled through resource control agreements that satisfy the requirements of Section 4.5.1.1.13. Thus, this provision in Section 4.5.1.2.1.1

[17] SCE AT 9-10.

merely obligates a scheduling coordinator applicant that becomes a scheduling coordinator to provide updated information on future changes regarding the control of resources through resource control agreements as specified in Section 4.5.1.1.13. Section 4.5.1.2.1.1 does not require a scheduling coordinator to provide any information – public or non-public – to an affiliate in violation of the CPUC affiliate transaction rules. As such, the CPUC affiliate transaction rules are inapplicable to the requirements of Sections 4.5.1.1.13 and 4.5.1.2.1.1.[18]

SCE incorrectly asserts that the information required by these provisions in Sections 4.5.1.1.13 and 4.5.1.2.1.1 is more easily accessible to the ISO than to scheduling coordinators, and that SCE "would not be aware of the resources *that its Affiliates* would control through RCAs [resource control agreements]."[19] Again, Sections 4.5.1.1.13 and 4.5.1.2.1.1 require scheduling coordinator applicants and scheduling coordinators to register resources that those entities themselves control through resource control agreements, not resources that affiliates control through resource control agreements. The scheduling coordinator applicants and scheduling coordinators, rather than the ISO, are in the best position to be aware of and provide information to the ISO about the resources that they themselves control.

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[18] Even if an affiliate of SCE (which is a scheduling coordinator) were to provide non-public information to SCE pursuant to Section 4.5.1.2.1.1, and SCE were then to provide that information to the ISO, the CPUC affiliate transaction rules would not apply. The CPUC affiliate transaction rules only concern the transfer of non-public information from a utility to an affiliate of the utility. Those CPUC rules do not concern the transfer of non-public information in the other direction – from a utility's affiliate to the utility. *See* CPUC affiliate transaction rules, Section II, available on the Internet at http://docs.cpuc.ca.gov/published/Graphics/63089.pdf.

[19] SCE at 10 (emphasis added).

The information required pursuant to Sections 4.5.1.1.13 and 4.5.1.2.1.1 is critically important for determining whether a market participant is a net buyer or a net seller for purposes of determining whether a transmission constraint for the day-ahead market is competitive or non-competitive as set forth in proposed Section 39.7.2.2(a). The ISO must understand whether the scheduling coordinator submitting bids on behalf of a resource is deciding how the resource is to participate in the ISO markets or whether another entity is deciding how the resource participates. For all of these reasons, the Commission should reject SCE's proposed revisions to these sections.

D. The CAISO Should Not Be Subject to Monthly Reporting Requirements

SCE acknowledges that the new LMPM approach "appears theoretically sound." Nevertheless, SCE argues that the ISO should prepare and file monthly public reports regarding the accuracy and efficiency of the new LMPM approach after it is implemented.[20] There is no reason for the ISO to prepare such monthly reports. The proposal set forth in the November 16 tariff amendment is the result of extensive analysis by the ISO and discussion with stakeholders over the course of approximately a year, from October 2010 to October 2011.[21] Thus, the ISO has every reason to believe that the new LMPM approach will work properly in all respects.

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[20] *Id.* at 5-8.

[21] *See* transmittal letter for November 16 tariff amendment at 4-5, 9 and Attachment G; Xu testimony at 11-19; McDonald testimony at 19-27 and Appendix A thereto.

Further, as explained above, the Market Surveillance Committee and the Department of Market Monitoring will be monitoring the operation and effectiveness of the revised LMPM process after it is implemented. If either of those monitoring entities observes issues with the revised LMPM approach, it will say so in a report that will be provided to the Commission and there is no need to create a new reporting obligation. The Market Surveillance Committee and the Department of Market Monitoring should not be required to commit their limited resources to the unnecessary task of preparing monthly reports, when no need for such reports has been shown. In addition, the ISO has already committed to analyzing mitigation data under its new process to determine whether implementing some mitigation threshold would be appropriate and producing reports of those analyses to stakeholders.

E. The CAISO Will Implement LMPM Stage Two as Soon as Practicable

WPTF argues that the ISO should implement LMPM Stage Two by the specific date of October 9, 2012, six months after the ISO's proposed effective date of April 11, 2012 for LMPM Stage One.[22] The Commission should reject WPTF's request for such a specific effective date for LMPM Stage Two. First, the ISO's tariff amendment as filed is just and reasonable by itself and the Commission's acceptance should not be conditioned on any further action. The ISO's proposal is a significant improvement compared with today's approach. Second, as explained in the November 16 tariff amendment, the ISO anticipates that it will take approximately six months after implementation of LMPM Stage

[22] WPTF at 10-12.

One to address the issues that must be resolved before LMPM Stage Two can go into effect – specifically, the numerous and complex changes that must be made to the ISO's market software in order to accommodate the increased demands and tighter time frames required by implementation of LMPM Stage Two. However, given the nature of the modifications required, and the fact that the ISO will not be able to implement even the first stage of its revised LMPM process until April of 2012,the ISO needs the flexibility to determine the timing of the implementation in light of all of the other enhancements currently planned. The Commission is simply not in a position to determine competing priorities and should not vault LMPM Stage Two ahead of other enhancement that may be equally or even more important.

Finally, WPTF would impose on the CAISO an arbitrary and artificial deadline that fails to take into account the time that may be needed to address the software complexities inherent in LMPM Stage Two. The ISO, not WPTF, is in the best position to evaluate how long it will take to make the necessary changes to the ISO's market software. Therefore, the Commission should permit the ISO to implement LMPM Stage Two as soon as practicable after the software complexities are resolved.

II. Conclusion

For the reasons explained above, the Commission should accept the November 16 tariff amendment as filed in this proceeding.

Respectfully submitted,

/s/ Bradley R. Miliauskas

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Dated: December 22, 2011

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all of the parties listed on the official service list for the above-referenced 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 22nd day of December, 2011.

/s/ Bradley R. Miliauskas
Bradley R. Miliauskas