

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

California Independent System Operator Corporation	)	Docket No. ER02-1656-025
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**MOTION FOR LEAVE TO FILE ANSWER TO PROTEST AND ANSWER OF  
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION  
("CAISO") TO COMMENTS ON, PROTEST OF, AND MOTION TO REJECT  
COMPREHENSIVE DESIGN PROPOSAL FOR INTER-SCHEDULING  
COORDINATOR TRADES UNDER THE CAISO'S  
MARKET REDESIGN AND TECHNOLOGY UPGRADE PROJECT**

**I. INTRODUCTION**

On March 15, 2005, the California Independent System Operator Corporation ("CAISO") filed with the Commission its Comprehensive Design Proposal for Inter-Scheduling Coordinator Trades ("Proposal"). The Proposal explains the terms under which the CAISO proposes to offer settlement of Inter-Scheduling Coordinator Trades ("Inter-SC Trades") of energy when it implements its Market Redesign and Technology Upgrade project ("MRTU"). The Proposal represents a complete, detailed description of the settlement services that the CAISO will provide for Inter-SC Trades of energy under the new market design and includes a description of Existing Zone Generation Trading Hubs ("EZ Gen Hubs") that the CAISO has developed through a stakeholder process as successor contract delivery points to today's existing congestion zones under a market design based on locational marginal pricing ("LMP"). If the Proposal is approved by the Commission, the CAISO will provide Inter-SC Trades at individual generation nodes and aggregated pricing points (trading hubs and load aggregation points) upon

implementation of LMP. Inter-SC Trades at individual generation nodes, however, will be subject to a physical validation requirement as described in the Proposal.

Two parties have moved to intervene in this proceeding without offering specific comments on the Proposal.<sup>1</sup> The CAISO does not oppose either motion. Several other parties intervened and commented<sup>2</sup> and one party intervened, protested and commented.<sup>3</sup> The CAISO does not oppose those interventions, but offers this response to the protest and some of the comments.<sup>4</sup>

## **II. MOTION FOR LEAVE TO ANSWER PROTEST**

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 requests leave to file an answer, and files this answer, to the protest submitted by SMUD. To the extent any part of this answer constitutes an answer to SMUD’s protest, the CAISO requests permission under Rule 213(a)(2), 18 C.F.R § 385.213(a)(2), to make this answer. Good cause for accepting this answer to SMUD’s protest exists 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. *See, e.g., Entergy Services, Inc.*, 101 FERC ¶

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<sup>1</sup> Coral Power, LLC and Sempra Generation intervened in this proceeding.

<sup>2</sup> The California Electricity Oversight Board (“EOB”), the California Energy Resources Scheduling Division of the California Department of Water Resources (“CERS”), the State Water Project of the California Department of Water Resources (“SWP”), the California Public Utilities Commission (“CPUC”), the Northern California Power Agency (“NCPA”), the City of Santa Clara-Silicon Valley Power (“SVP”), Sacramento Municipal Utility District (“SMUD”), the City of Roseville (“Roseville”), and the Transmission Agency of Northern California (“TANC”) intervened and commented on the CAISO’s Proposal.

<sup>3</sup> The Sacramento Municipal Utility District (“SMUD”) intervened, protested and commented on the CAISO’s Proposal.

<sup>4</sup> No leave is required for the CAISO to respond to the comments that were included with some of the interventions.

61,289, at P 6 (2002); *Duke Energy Corp.*, 100 FERC ¶ 61,251 at P 10 (2002); and *Delmarva Power & Light Co.*, 93 FERC ¶ 61,098 at 61,259 (2000).

### **III. ANSWER TO COMMENTS AND TO PROTEST**

The only industry segment that expressed concerns with the Proposal is the municipal community.<sup>5</sup> The comments submitted by the municipals fall into two general categories: i) concerns relating to the overall MRTU design, with no direct linkage to the proposed Inter-SC Trade design; and ii) concerns relating specifically to the Inter-SC Trade design. The great majority of their concerns fall into the first category.

With respect to that first category, the CAISO appreciates that the transition from today's market design to the proposed MRTU design represents a significant change for all market participants, including the municipal utilities. The CAISO further recognizes that the first category of concerns expressed by the municipal community includes several very important issues that must be resolved prior to implementation of MRTU (*e.g.*, Congestion Revenue Rights, treatment of existing transmission contracts, credit and collateral issues). The CAISO is fully committed to working with the municipal community and other stakeholders to resolve them. This filing, however, is not the appropriate forum to address these issues, and the municipals' raising of these issues should not preclude the Commission's favorable action on the Proposal.

The few issues raised by the municipals in the second category either reflect a misunderstanding of the Proposal or are simply misplaced. The CAISO believes its clarifications and responses to these issues will enable the Commission to address those issues and approve the

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<sup>5</sup> CERS, CPUC, EOB, and SWP filed comments in strong support of the Proposal as filed.

Proposal. The CAISO reiterates its request that the Commission approve the Proposal without modification by mid-May so that the issue of the compatibility of pre-existing seller's choice contracts with LMP can be laid to rest and market participants and CAISO staff can focus on the hard work that remains in order to finalize other aspects of the MRTU design, including the very important issue of allocation of Congestion Revenue Rights ("CRRs").

As discussed further below, the CAISO strongly opposes SMUD's motion to reject the Proposal as somehow incomplete.<sup>6</sup> The CAISO also strongly opposes SMUD's request that the Commission establish an evidentiary hearing to consider the Proposal.<sup>7</sup> SMUD's request is without merit because there are no "material issues of disputed fact" concerning the Proposal and there is, therefore, no basis to extend the review of the Proposal. In addition, the CAISO strongly opposes SMUD's suggestion that the Commission has adequate time to delay approval of this Proposal until after the CRR study is completed later this summer.<sup>8</sup> As the CAISO noted in its transmittal letter, Commission approval of the Proposal and the contracting parties' settlement agreements by mid-May is critically important to the CAISO's efforts to meet a February 2007 implementation date for MRTU.<sup>9</sup> Further delay in resolving the seller's choice issue could significantly affect the CAISO's ability to meet the February 2007 implementation date, as lingering uncertainty on this issue may cause the CAISO to reconsider the prudence of expending additional dollars on LMP implementation until the issue is resolved.

Finally, it is critically important that the Commission approve the Proposal without modification, because such approval is a condition precedent for several settlement agreements

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<sup>6</sup> See discussion at Section III.A of this Answer.

<sup>7</sup> SMUD Protest at 21-22.

<sup>8</sup> SMUD Protest at 14-15.

<sup>9</sup> CAISO Proposal at 2-3, 19.

that parties have negotiated in the seller's choice proceeding (Docket No. EL04-108).<sup>10</sup> Since the Proposal was filed several more contracts were resolved contingent on approval of the Proposal without modification.<sup>11</sup> If the Proposal is either disapproved or modified in a manner that settling parties determine is unacceptable, the CAISO believes that the settlement agreements may unravel, and that litigation in that proceeding might be unavoidable. Accordingly, the CAISO once again reiterates the importance of the Commission's approving the Proposal without modification.

**A. The Commission Can Approve the Proposal Now and Subsequently Address Implementing Tariff Language**

In its protest, SMUD requested that the Commission reject the CAISO's filing, arguing the filing was incomplete due to the absence of tariff pages.<sup>12</sup>

The purpose of filing the Proposal without tariff pages is to solicit the Commission's guidance and to ensure that the key elements of the Proposal are supported by the Commission before the CAISO undertakes the effort of developing, at significant cost, software to support its settlement of Inter-SC Trades. The Commission has previously acted favorably on a similar CAISO request for approval of the elements of its intended treatment of existing transmission contracts ("ETCs").<sup>13</sup> In the instant proceeding, it is also necessary to obtain Commission

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<sup>10</sup> See CAISO Proposal at 4.

<sup>11</sup> See Joint Offer of Settlement of California Department of Water Resources, Calpine Energy Services and Power Contract Financing LLP, filed in Docket No. EL04-108-000 on April 8, 2005 and Offer of Settlement of California Energy Resources Scheduling Division (with Sempra Generation), filed in Docket No. EL04-108-000 on April 7, 2005.

<sup>12</sup> SMUD Protest at 5-6. SVP also noted the absence of Tariff language in its comments. SVP Comments at 3.

<sup>13</sup> See, e.g., *California Independent System Operator Corporation Guidance*, 110 FERC ¶ 61,113 (2005) ("ETC Order") in which the Commission "approv[ed] . . . the ETC Proposal components . . . in principle only" in response to a CAISO request regarding "whether the components of its ETC Proposal [were] acceptable [to the Commission] so that the CAISO [could] proceed with the development of the software and systems required to implement this aspect of its market redesign and the preparation of detailed tariff sheet amendments." *Id.* at P. 2.

approval of the Proposal now, even before tariff pages are prepared as part of the larger tariff filing on MRTU, in order to confirm the settlement of the sellers' choice issues in Docket No. EL04-108 and permit the CAISO to continue development of MRTU on the current schedule. While the CAISO is seeking Commission approval of its Proposal now, the CAISO understands that even if the Proposal is approved without modification, the CAISO may not implement the policies and practices that constitute the Proposal until the implementing tariff language is subsequently approved by the Commission.

As the CAISO stated in its Proposal, it will submit tariff language to the Commission as part of a comprehensive MRTU tariff, scheduled for later this year.<sup>14</sup> If the Commission approves the Proposal as sought by the CAISO, the CAISO presumes that the Commission will approve the related tariff language to the extent the tariff language reflects the policies and practices constituting the Proposal. The CAISO also is confident that if any of the forthcoming tariff language inadvertently deviates from the policies and practices that constitute the Proposal, counsel for SMUD or other parties to the proceeding will bring the deviation to the Commission's attention so that the language can be examined and modified if necessary.

**B. Many Comments About and Criticisms of the Proposal Are, in Fact, Comments About or Criticisms of the Larger MRTU Design**

Many of the comments mistakenly attribute to the Proposal concerns that are more appropriately attributed to the CAISO's decision to implement an LMP-based energy market as the core of its MRTU project. The decision to use an LMP-based congestion management system as the core of a forward energy market was included in other CAISO proposals, and

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<sup>14</sup> CAISO Proposal at 2, 19.

already has been approved by the Commission.<sup>15</sup> The instant Proposal is intended to address the relatively narrow issue of how to settle Inter-SC Trades of energy under the new market design. While the CAISO appreciates the concerns expressed in the comments, the CAISO believes that such concerns are misplaced in this proceeding because the Proposal does not represent the CAISO's decision to implement LMP, but rather helps to resolve a problem that would have arisen once LMP is implemented. Accordingly, none of these concerns should have any effect on the Commission's review and approval of the Proposal.

**1. The Double Settlement Issue Results From Establishment of a Forward Energy Market, Not This Proposal**

SMUD characterized the Proposal as locking in a feature of the new market design in which every transaction must be settled through the CAISO, creating a double settlement which must be addressed, and making normal bilateral settlement more complex.<sup>16</sup> The double settlement about which SMUD is concerned, however, is not a feature of the Proposal, but is a direct result of scheduling bilateral contracts in the CAISO's new forward energy market. Specifically, the double energy settlement arises because schedules resulting from bilateral contracts will be settled in the CAISO's forward energy market, while the parties also will settle contracts bilaterally outside of the CAISO's markets.<sup>17</sup> Because the decision to establish an LMP-based forward energy market was made by the CAISO and approved by the Commission prior to the development of this Proposal,<sup>18</sup> SMUD's concerns are misdirected, and should in no way preclude the Commission from reviewing and approving the Proposal at this time.

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<sup>15</sup> See, e.g., *California Independent System Operator Corporation*, 105 FERC ¶ 61,140 at P 3 (2003) ("October 2003 Order").

<sup>16</sup> SMUD Protest at 8.

<sup>17</sup> See CAISO Proposal at 8.

<sup>18</sup> See October 2003 Order at P 3.

## 2. Settlement of Inter-SC Trades at Interties Is Unnecessary

SMUD noted that the CAISO will not settle trades at interties, and scolded the CAISO for “deny[ing] out-of-control-area entities the same rights as entities scheduling within the ISO Control Area.”<sup>19</sup> First, the CAISO notes that Inter-SC Trades are not currently provided at interties, so the services offered under the new market design simply reflect the services offered now in that respect.

More importantly, however, there is no need to settle Inter-SC Trades at interties under MRTU. A simple example will demonstrate why this is the case. Assume a buyer has a bilateral energy purchase outside of the CAISO Control Area and is using that transaction to serve either load within the CAISO Control Area or an export to another control area. The buyer and seller will need to agree on how to allocate congestion costs associated with getting the energy from the intertie from which it is provided (the source) to the sink (load aggregation point (“LAP”) for internal load, export intertie for external load). If the buyer agrees to bear the congestion cost, the buyer can simply schedule the import. In doing so, it will collect the LMP for the import but then will be charged the LMP for its load or export schedule and the net settlement will reflect the congestion costs. Conversely, if the seller agrees to bear the congestion costs, the seller will schedule the import. In this instance, if the buyer is using the import to serve load internal to the CAISO Control Area, the buyer and seller can enter into an Inter-SC Trade at the buyer’s LAP and, in doing so, the seller will effectively bear the congestion costs, which are equal to the difference between the import LMP and the LAP price. If the buyer is using the import to serve an export to another control area, the seller will also schedule the export and again, the seller will

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<sup>19</sup> SMUD Protest at 10.

bear the congestion costs from the import injection point to the export withdrawal point.<sup>20</sup>

Accordingly, bilateral transactions at interties can be easily accomplished without having Inter-SC Trades at interties.

This issue was thoroughly discussed during the stakeholder process leading up to this filing and no market participant contended that Inter-SC Trades at interties were necessary. Moreover, physical validation of bilateral deliveries from imports is accomplished through North American Electric Reliability Council tagging procedures that are part of the general scheduling practices for interties.

### **3. The Proposal Will Not Create Seams Issues**

SMUD protested that the manner in which the CAISO will settle forward market transactions under MRTU will create seams issues with neighboring control areas because Inter-SC Trades will not be available to generation originating outside the CAISO Control Area or to schedules at interties.<sup>21</sup>

The CAISO's Proposal will not, however, frustrate imports from or exports to other control areas. Under the MRTU-LMP design, generation originating outside the CAISO Control Area will schedule to the CAISO Control Area by submitting intertie schedules, as is the case today. As described in the prior section, bilateral transactions associated with intertie schedules can easily be scheduled and settled under MRTU without the need for Inter-SC Trade settlement services at intertie points.

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<sup>20</sup> Unlike internal generating resources, which are limited to having only one designated Scheduling Coordinator, any Scheduling Coordinator can submit schedules at interties. In scheduling both the import and export, the seller in this example has a net-market settlement with the CAISO that reflects the congestion costs between these two points.

<sup>21</sup> SMUD Protest at 12.

#### **4. The Proposal Will Not Affect Resolution of the ETC “Perfect Hedge” Issue**

TANC characterized the absence of a definitive resolution of the “perfect hedge” mechanism to address the congestion risk associated with ETCs as a shortcoming of the Proposal.<sup>22</sup> SVP noted in its comments that use of the Inter-SC Trade software platform was only one alternative to addressing the ETC issue, and that other alternatives were available.<sup>23</sup>

As TANC’s comments tacitly acknowledge, the development of the “perfect hedge” is not an Inter-SC Trade issue, but is a direct outgrowth of the establishment of an LMP-based energy market.<sup>24</sup> The only relationship between the Inter-SC Trade policy and the efforts to develop the “perfect hedge” is that one of the potential means to effectuate the bilateral settlement of ETC schedules would be to credit back congestion costs using the software system being developed for Inter-SC Trades. Approval of the CAISO Inter-SC Trade design would not foreclose this option.

The Proposal for which the CAISO is seeking Commission approval pertains to the Inter-SC Trade settlement services that will be offered for general bilateral energy transactions. Settlement of ETC schedules is a separate market design/policy issue. Any overlap pertains only to software issues and whether the perfect hedge for ETC schedules could be most effectively implemented through using the Inter-SC Trade settlement software.

The possibility that the CAISO may use the Inter-SC Trade software platform to resolve the ETC problem, however, should not have any effect on the Commission’s review and approval of the Inter-SC Trade Proposal. Moreover, nothing in the Proposal precludes the

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<sup>22</sup> TANC Comments at 8-9.

<sup>23</sup> SVP Comments at 5.

<sup>24</sup> TANC Comments at 7-8.

CAISO's use of the Inter-SC Trade software platform to support other Commission objectives. Accordingly, the resolution of the ETC issue, and the development of the "perfect hedge," should in no way preclude the Commission from reviewing and approving the Proposal at this time.

**5. The Proposal Does Not Preclude the Establishment of Settlement Services for Inter-SC Trades of Ancillary Service Obligations**

SVP noted the importance of Inter-SC Trades of ancillary service obligations to its operations.<sup>25</sup> The settlement of Inter-SC Trades of ancillary service obligations is a distinct service from the settlement of Inter-SC Trades for forward energy transactions. The development of a settlement service for Inter-SC Trades of ancillary service obligations, therefore, is more appropriately an MRTU issue than an issue related to the settlement of Inter-SC Trades of forward energy transactions. Moreover, nothing in the CAISO's Proposal precludes the development of Inter-SC Trades for ancillary service obligations.<sup>26</sup> Accordingly, the absence of a policy to facilitate Inter-SC Trades of ancillary service obligations should in no way preclude the Commission from reviewing and approving the Proposal at this time.

**6. Concerns About Creditworthiness and Collateral Will Be Addressed As Part of a Comprehensive Credit Policy for the Entire MRTU Market Design**

NCPA expressed concern that the requirement that forward bilateral transactions be settled in the CAISO market elevates market participants' credit risk by constraining their ability

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<sup>25</sup> SVP Comments at 5.

<sup>26</sup> The CAISO plans to address the issue of whether it can provide functionality for Inter-SC Trades of ancillary service obligations prior to the MRTU tariff filing, currently slated for November 2005. If this functionality can be provided without compromising the February 2007 implementation schedule and there is strong stakeholder support for it, the CAISO will include an Inter-SC Trade design for ancillary service obligations in its MRTU tariff filing.

to deal only with creditworthy counterparties,<sup>27</sup> and SMUD expressed concern that the CAISO's operation of a day-ahead and hour-ahead energy market will expose market participants to greater credit risk.<sup>28</sup> But as NCPA itself stated, the credit issues arise "[b]ecause the CAISO's MRTU design requires all transactions to clear through the CAISO markets and settle financially as well."<sup>29</sup> NCPA went on to acknowledge that while parties previously "could control to some extent their exposure to the CAISO markets and uncreditworthy market participants," "[u]nder MRTU this will no longer be possible."<sup>30</sup> In other words, once again, the issues that NCPA and SMUD identified arise as a result of the MRTU design,<sup>31</sup> and not because of this Proposal.

NCPA also expressed concern that some market participants may face significant increases in the amount of collateral that they must post with the CAISO in order to participate in the market at the same level as under the current market design.<sup>32</sup> NCPA's concern, once again, is in fact a concern about the effects of establishing a forward energy market, which will require the settlement of all transactions associated with final schedules through the CAISO in order to ensure that all market participants account for congestion costs, which will be incorporated into energy costs.

As the CAISO noted in its Transmittal Letter,<sup>33</sup> the CAISO intends to address a credit and collateral policy for Inter-SC Trades in the context of developing a comprehensive credit and

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<sup>27</sup> NCPA Comments at 2-3.

<sup>28</sup> SMUD Protest at 8, 19-20.

<sup>29</sup> NCPA Comments at 2.

<sup>30</sup> NCPA Comments at 2.

<sup>31</sup> Specifically, the implementation of a forward energy market, which requires settling all energy schedules in order to effectively allocate congestion costs. This requirement would arise even if the forward energy market were a zonal market (*i.e.*, it is not unique to an LMP market).

<sup>32</sup> NCPA Comments at 2-3.

<sup>33</sup> CAISO Proposal at 17.

collateral policy for the entire MRTU market design. Accordingly, the absence of a policy to resolve collateral and creditworthiness issues should in no way preclude the Commission from reviewing and approving the Proposal at this time.

**7. CRR Allocation and Design, Which Are Not Affected by the Proposal, Will Be Comprehensively Addressed After Completion of the CRR Studies**

NCPA stated that the CAISO has not yet provided sufficient information about CRR allocation to allow for a fair evaluation of the proposed market design.<sup>34</sup> Roseville noted that the absence of information about the allocation of CRRs has hindered its ability to evaluate the consequences of the MRTU project.<sup>35</sup> SMUD's protest echoed NCPA's and Roseville's concerns, and expressed further concern that the Proposal does not address the duration of CRRs.<sup>36</sup>

The CAISO appreciates that market participants eagerly await results of the CAISO's CRR studies, because they will provide market participants a better understanding of the economic consequences of the new market design for their operations. Roseville, for instance, characterized its concern as an inability to "evaluate the impact of the market redesign on the balance of benefits and burdens under the Roseville/MSCG contract."<sup>37</sup> Nevertheless, the incorporation of congestion costs into energy prices and the creation of CRRs to allow market participants to better manage congestion risks is a direct result of the CAISO's implementation of an LMP-based market design, and not of its proposed Inter-SC Trade design.<sup>38</sup> Accordingly,

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<sup>34</sup> NCPA Comments at 1-2.

<sup>35</sup> Roseville Comments at 4.

<sup>36</sup> SMUD Protest at 12-17.

<sup>37</sup> Roseville Comments at 4.

<sup>38</sup> A major objective of the proposed Inter-SC Trade design is to eliminate potential congestion costs associated with seller's choice contracts that are unrelated to the physical capabilities of the grid and therefore would

(... continued)

while completion of the CRR study will inform market participants about their potential congestion costs under LMP and allow them to better evaluate the risk that the transition affects their property, the outcome of such studies should not affect the scope or details of the CAISO's Proposal, which addresses settlement of Inter-SC Trades for energy under the new market design. That the CAISO has not yet completed its CRR studies should in no way preclude the Commission from reviewing and approving the Proposal at this time.

NCPA also noted a lack of clarity regarding how parties would obtain CRRs either to or from hubs, since CRRs are expected to be distributed only to load,<sup>39</sup> and SMUD noted an uncertainty regarding the allocation of CRRs to load located outside the CAISO Control Area.<sup>40</sup> While the CAISO acknowledges that these issues regarding the distribution of CRRs have not yet been resolved, the CAISO has indicated that it will seek to distribute as large a volume of CRRs as can be physically supported by the constraints of the grid. In any event, these gaps in the CRR allocation/distribution process demonstrate the importance of resolving the Inter-SC Trade issue through approval of the CAISO's Proposal so that all parties, including the CAISO, may concentrate on CRR studies and the policies and practices regarding the allocation of CRRs.

**8. The CAISO Remains Committed to an LMP-Based Market Design, a Design Supported and Approved by the Commission, Once Congestion Risks Are Addressed Adequately**

SVP questions the CAISO's stated commitment to implement an LMP-based market design, as the CAISO indicated a commitment to implement LMP only if its major load-serving

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be unhedgeable. With that issue addressed through the Inter-SC Trade design, there remain concerns about the adequacy of CRRs and their allocation. These concerns, as expressed by the municipal community and others, are unrelated to the concern about congestion costs inherent in the seller's choice issue but rather, are general concerns associated with the ability to hedge congestion costs that are inherent in an LMP market design.

<sup>39</sup> NCPA Comments at 2.

<sup>40</sup> SMUD Protest at 14.

entities can use CRRs to effectively manage congestion risk.<sup>41</sup> SVP suggests that the CAISO should be concerned about all parties' ability to use CRRs to manage their congestion risk.<sup>42</sup>

SVP is mischaracterizing the CAISO's intent. While the CAISO did express its commitment to implement an LMP-based market design only if its major load-serving entities could use CRRs to effectively manage congestion risk, that does not mean that the CAISO is not committed to developing a system that will allow every market participant to manage its congestion risk. The CAISO's statement simply reflected the reality that it would not allow the perfect to become the enemy of the good, and commit to abandon LMP if it could not resolve every single market participant's concerns. In any event, SVP's comment really addresses the CAISO's decision to implement an LMP-based market design, and not the current Proposal. Accordingly, SVP's concern should in no way preclude the Commission from reviewing and approving the Proposal at this time.

SVP also commented that while the CAISO characterized LMP as a superior market design, it has not been proven superior to other market designs.<sup>43</sup> The CAISO notes that the Commission has long supported the implementation of LMP-based congestion management because of its ability to efficiently manage grid congestion.<sup>44</sup> The CAISO decided to adopt LMP, and the Commission decided to approve LMP,<sup>45</sup> because of their shared belief in the ability of that design to effectively manage congestion and support reliable grid operation. In any event, SVP's discussion of whether the LMP congestion-management system is superior to

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<sup>41</sup> SVP Comments at 4.

<sup>42</sup> SVP Comments at 4.

<sup>43</sup> SVP Comments at 4.

<sup>44</sup> *See, e.g.*, Remediating Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design, FERC Stats. & Regs., Proposed Regulations ¶ 32,564 at P 10 (July 31, 2002).

<sup>45</sup> *See* October 2003 Order at PP 47-50.

other market designs is misplaced, as it relates to the CAISO's decision to implement LMP and the Commission's standard market design, not to the Inter-SC Trade Proposal. SVP's comments should in no way preclude the Commission from reviewing and approving the Proposal at this time.

### **9. The New CAISO Market Design Will Have Undergone Sufficient Examination To Ensure Its Soundness**

SMUD states that the complexity of the MRTU design coupled with the CAISO's Proposal will enhance opportunities for gaming and that the MRTU design should therefore be phased in as cautiously as possible. SMUD, however, identifies nothing about the CAISO's Inter-SC Trade Proposal itself that SMUD feels is excessively complex and prone to gaming, but instead expresses a general concern about the complexity of the entire MRTU design, of which the Inter-SC Trade Proposal is a part.<sup>46</sup>

It is difficult to respond to such a general expression of concern except to note that the CAISO is proceeding cautiously with the MRTU project and making every effort to ensure the new market design is sound and not overly complex. As the Commission is well aware, the CAISO acquired the services of LECG Consulting, a renowned expert in LMP market design, which conducted a comprehensive assessment of the MRTU conceptual design. The assessment identified several concerns that the CAISO is either correcting or continuing to assess, but concluded generally that "[t]he starting principles of the MRTU embrace the essential foundations of a successful electricity market design including bid-based, security-constrained, economic dispatch with locational prices, license plate access charges, bilateral schedules, financial transmission rights, a consistent network model for commercial transactions recognizing actual physical conditions, consistent day-ahead and real-time markets, unit

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<sup>46</sup> SMUD Protest at 20-21.

commitment with simultaneous optimization of energy and ancillary services, and a multi-settlement system.”<sup>47</sup>

The CAISO will continue to review and assess the design from the conceptual level all the way to the detailed implementation level. It should be noted that one of the primary reasons for seeking resolution of fundamental policy issues at this time is so that the CAISO can develop the final design with sufficient time to perform proper system integration and testing. The CAISO’s implementation schedule calls for significant testing and market simulation prior to going live in February 2007, which will provide additional opportunities to identify any problematic aspects of the design and make necessary corrections. Therefore, the CAISO believes it is taking a sound and prudent approach to implementing the new design and SMUD’s general concerns regarding this issue should not cause the Commission to delay review of the CAISO’s Proposal.

#### **10. The Proposal Does Not Force Market Participants To Settle Transactions Through the CAISO**

SMUD stated in its protest that the Proposal will force market participants to settle transactions through the CAISO, effectively converting existing bilateral contracts into trilateral contracts.<sup>48</sup> In fact, the requirement that parties settle their forward energy purchases through the CAISO is a consequence of the adoption of an LMP-based forward market, and not a result of the CAISO Proposal regarding the settlement of Inter-SC Trades.<sup>49</sup> Accordingly, such concerns

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<sup>47</sup> Comments on the California ISO MRTU LMP Market Design, by Scott M. Harvey and Susan L. Pope (Law & Economics Consulting Group, LLC) and William W. Hogan (Harvard University), at p. 1, available at <http://www.caiso.com/docs/2005/02/23/200502231634265701.pdf>.

<sup>48</sup> SMUD Protest at 7-8.

<sup>49</sup> CAISO Proposal at 4.

are not within the scope of this proceeding, and SMUD's concern should in no way preclude the Commission from reviewing and approving the Proposal at this time.

**C. None of the Concerns Expressed About the CAISO Proposal Should Prevent the Commission From Approving It Now**

**1. The Proposal Is Sufficiently Detailed to Permit the Commission to Conclude That It Is Just and Reasonable**

Several of the comments filed by intervenors suggest that the Commission should not approve the Proposal because the CAISO's filing was not sufficiently detailed to permit parties to adequately review it. The CAISO believes, however, that the Proposal contains ample detail for the Commission to approve the policies and practices embodied in the Proposal, while recognizing that they may not be implemented until the Commission approves tariff sheets that the CAISO expects to file at the Commission later this year.

**a. The CAISO Proposal is Complete**

In addition to the concern expressed by SMUD and SVP that the CAISO's filing was incomplete due to the absence of tariff pages, which was addressed above in Section III.A of this Answer, SVP also suggested that the CAISO's Proposal was incomplete because it did not fully resolve three issues – credit and collateral policies, treatment of ETCs under MRTU, and the availability of settlement services for Inter-SC Trades of ancillary service obligations.<sup>50</sup> However, these issues are, in fact, separable from the Proposal in that *regardless of how they are resolved*, they will have no impact on the proposed Inter-SC Trade design for bilateral energy transactions. Accordingly, the CAISO believes that comments regarding these issues are

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<sup>50</sup> SVP Comments at 3.

misplaced, and that their pending resolution should in no way preclude the Commission from reviewing and approving the CAISO's Proposal at this time.<sup>51</sup>

**b. The CAISO Proposal Contains Sufficient Information About the Development of Existing Zone Generation Trading Hubs To Permit Its Approval**

Roseville noted that the CAISO has not yet identified the precise weighting factors that will be used to calculate energy prices at EZ Gen Hubs.<sup>52</sup>

The CAISO conducted an extensive stakeholder process on the issue of trading hubs under LMP, which culminated in general stakeholder agreement that the CAISO should develop EZ Gen Hubs as successor delivery points under LMP for today's existing internal congestion zones (NP15, SP15, and ZP26).<sup>53</sup> Furthermore, there was general stakeholder agreement on a basic definition of EZ Gen Hubs, in that they would be formulated to represent the average price paid to generation within the zone and as such, will be based only on LMPs at generation nodes.<sup>54</sup> The CAISO incorporated this basic definition of EZ Gen Hubs into the Inter-SC Trade Proposal and is seeking the Commission's approval of the EZ Gen Hubs as part of the Proposal.

The CAISO acknowledged in its filing that it has not yet developed the precise weighting factors for calculation of the EZ Gen Hub price, but emphasized its commitment to an open stakeholder process to develop such criteria and identified the issues that it believes need to be considered in developing the precise formula.<sup>55</sup> The CAISO does not believe that the Proposal should be viewed as incomplete simply because exact minutiae of how the EZ Gen Hub price

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<sup>51</sup> See Sections III.B.4, 5 and 6, above.

<sup>52</sup> Roseville Comments at 4.

<sup>53</sup> CAISO Proposal at 3, 16.

<sup>54</sup> CAISO Proposal at 16.

<sup>55</sup> CAISO Proposal at Attachment A, at 5-6.

will be calculated have not been finalized. What is important to the completeness of the Proposal is that there is a clear definition of what the EZ Gen Hub is intended to represent.<sup>56</sup>

**c. The CAISO Decision To Determine the Precise Length of the Final Trading Period at a Later Time Does Not Render the Proposal Incomplete**

TANC also characterized the Proposal as incomplete because the CAISO has not yet defined the length of the Final Trading Period.<sup>57</sup> However, the precise duration of the Final Trading Period, or whether a Final Trading Period can even be provided in the Hour-Ahead Scheduling Process (“HASP”), is an implementation detail that the CAISO felt was appropriate to finalize after the MRTU software systems are further developed and tested. The only reason that resolution of these issues is being deferred is so that the final resolution can provide maximum flexibility to market participants in light of the constraints of the software systems. These implementation details do not rise to the level of constituting an incomplete proposal. If that were the case, the CAISO would simply put forward a definitive proposal that the Final Trading Period in the Day Ahead market be limited to 30 minutes and that there be no Final Trading Period in HASP. The CAISO suspects most market participants would prefer to see this issue deferred, rather than having the CAISO lock in such a conservative position.

**2. Contracts for Renewable Energy Are Not Inconsistent With the Inter-SC Trade Proposal**

SMUD expressed concern that default settlement of contracts for the purchase of renewable energy will be at the EZ Gen Hub price, which is not the correct price for renewable

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<sup>56</sup> An analogy can be made to the concept of Load Aggregation Points (“LAPs”) for load scheduling and settlement under LMP, which the Commission approved. October 2003 Order at P 65. The CAISO did not provide details on the precise methodology for determining the Load Distribution Factors (“LDFs”) for allocating load schedules from the LAP to the individual nodes in the network.

<sup>57</sup> TANC Comments at 5.

energy.<sup>58</sup> The CAISO, however, believes that the problem identified by SMUD can be avoided by not using the CAISO's Inter-SC Trade settlement service to settle contracts for the delivery of renewable energy. As the CAISO noted in its filing, use of the CAISO's settlement services for Inter-SC Trades is not mandatory for any party except those parties who have agreed to use the CAISO's settlement service.<sup>59</sup> Alternatively, if SMUD wanted to use the Inter-SC Trade settlement service but desired an alternate settlement to the EZ Gen Hub price for curtailed Inter-SC Trades at a generation node, it could do so through a bilateral contract for differences with its counter-party. Accordingly, the Proposal does not represent any obstacle to contracts for the delivery of renewable energy under the new market design, and SMUD's concern should in no way preclude the Commission from reviewing and approving the Proposal at this time.

### **3. Use of the CAISO's Inter-SC Trade Settlement Service Is Optional, Unless Parties Have Voluntarily Committed to Use It**

SMUD stated that “[w]hile the ISO states that use of its Inter-SC Trade settlement service is voluntary, and further implies that it will therefore have no adverse effect on any party, the ISO goes on to state that if parties opt to settle using an Inter-SC Trade, they must settle their trades ‘in accordance with the [ISO’s] Inter-SC Trade rules.’”<sup>60</sup> SMUD misstated the CAISO's Proposal: the CAISO's proposal does not require, nor could it,<sup>61</sup> that any bilateral trades be settled in accordance with the CAISO's Inter-SC Trade rules, other than those trades for which the parties elect to have the CAISO provide settlement services. In other words, the term “Inter-

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<sup>58</sup> SMUD Protest at 18-19.

<sup>59</sup> CAISO Proposal at 5, 10.

<sup>60</sup> SMUD Protest at 9 (citations omitted).

<sup>61</sup> It would be impossible for the CAISO to force all market participants to settle bilateral transactions through Inter-SC Trades because bilateral arrangements are invisible to the CAISO – it only knows about bilateral arrangements to the extent Inter-SC Trades are submitted for settlement.

SC Trade” refers to trades submitted to and settled by the CAISO. As the CAISO stated in its filing, the Proposal “simply dictates that *if* [market participants] choose to use the CAISO’s Inter-SC Trade mechanism for settling their contracts, the trades will be settled by the CAISO in accordance with its Inter-SC Trade rules.”<sup>62</sup> In other words, the only market participants that will be required to abide by the CAISO’s Inter-SC Trade rules will be those parties who have chosen of their own accord to settle their bilateral transactions using the CAISO’s settlement services.<sup>63</sup> As the CAISO noted in its Proposal, however, “the settlement service provided by an Inter-SC Trade could be performed bilaterally (*i.e.*, without the use of the CAISO’s Inter-SC Trade mechanism).”<sup>64</sup> The CAISO even provided an example in which the parties settled their bilateral contract without using the CAISO Inter-SC Trade mechanism.<sup>65</sup>

Finally, SMUD erroneously argues that the CAISO’s Proposal mandates that ETCs be settled through the Inter-SC Trade proposal and offers this as another argument for why the Proposal is not voluntary.<sup>66</sup> As the CAISO noted in its transmittal letter, bilateral settlements of ETC schedules need to be settled in the CAISO market under LMP in order to facilitate the credit-back of congestion charges under the proposed ETC “perfect hedge” mechanism, but it is unclear at this point whether this settlement would be best effectuated through the use of the Inter-SC Trade software or through an alternative settlement mechanism. In any event, and as previously discussed, the settlement and treatment of ETC schedules is not part of this Proposal.

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<sup>62</sup> CAISO Proposal at 18 (emphasis added)

<sup>63</sup> For example, CERS has entered into settlement agreements with other parties, including Sempra Generation and Calpine, in which the parties agreed that certain deliveries of energy under the contract would be made as Scheduling Coordinator to Scheduling Coordinator trades settled by the CAISO pursuant to the CAISO tariffs, rules or protocols, which include the Proposal. *See, e.g.* Offer of Settlement between CERS and Sempra, filed at the Commission in Docket No. EL04-108-000, on April 7, 2005, at p. 14.

<sup>64</sup> CAISO Proposal at 12.

<sup>65</sup> *See* Example 3 and accompanying text in CAISO Proposal. *Id.* at 12-13.

<sup>66</sup> SMUD Protest at 11.

The Proposal for which the CAISO is seeking Commission approval pertains to the Inter-SC Trade settlement services that will be offered for general bilateral energy transactions.

Settlement of ETC schedules is a separate market design/policy issue.

**4. Inter-SC Trades Will Be Provided in the Hour-Ahead Scheduling Process (“HASP”) Regardless of Whether the CAISO Can Provide a Final Trading Period in the HASP**

SVP states that the development of a “Final Trading Period” is of critical importance in the HASP, particularly to entities that load-follow pursuant to a Metered Subsystem (“MSS”) Agreement.<sup>67</sup> In response to SVP, the CAISO would like to clarify that, as described in the Proposal,<sup>68</sup> the CAISO will provide Inter-SC Trade settlement services for the HASP. Therefore, SVP will have the “ability to change other schedules (other than invalid Inter-SC Trades) so that it can remain in balance and within the rules of the MSS Agreement” under the Proposal.

What remains at issue is whether there will be sufficient time in the HASP between the market closing and the posting of final market results to have a “Final Trading Period.” A “Final Trading Period” is by definition a period between the deadline for submitting market bids and schedules (*i.e.*, market closure) and the time at which market results are posted.<sup>69</sup> Therefore, by definition, it will not be possible for an SC to modify its market schedules and bids during a Final Trading Period. The Final Trading Period is simply some additional time that the CAISO is providing for SCs to conduct additional Inter-SC Trades. Accordingly, the absence of resolution on whether there will be a Final Trading Period in the Hour-Ahead Scheduling Process should in no way preclude the Commission from reviewing and approving the Proposal at this time.

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<sup>67</sup> SVP Comments at 5.

<sup>68</sup> See Comprehensive Design Document, page 2, lines 6-12.

<sup>69</sup> CAISO Proposal at Attachment A, at 3.

## **5. Inter-SC Trades Can Be Used for Demonstrating Compliance with MSS Balancing Requirements**

SVP commented that the CAISO's characterization of the Inter-SC Trade function as having no role in scheduling in the forward energy market was incorrect, as SVP's MSS Agreement contains provisions that effectively require SVP to use Inter-SC Trades.<sup>70</sup> The simple point the CAISO was attempting to make regarding this issue is that under MRTU, the Integrated Forward Market ("IFM") never sees Inter-SC Trades. The IFM only deals with schedules from physical resources and take-out points (*e.g.*, LAPs). Inter-SC Trades are simply a settlement service that happens outside of the IFM. To the extent Inter-SC Trades under MRTU could serve an additional role of validating whether an MSS complied with the balancing provisions contained in its MSS Agreement, nothing in this Proposal would foreclose that.

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<sup>70</sup> SVP Comments at 3-4.

**IV. CONCLUSION**

For the foregoing reasons, the CAISO respectfully requests that the Commission approve the Proposal without modification.

Respectfully submitted,

/s/ J. Phillip Jordan

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Dated: April 27, 2005

### **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 27<sup>th</sup> day of April in the year 2005 at Folsom in the State of California.

/s/ Sidney Mannheim Davies  
Sidney Mannheim Davies