

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

**California Independent System)
Operator Corporation)** **Docket No. EL05-114-000**

**MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO
COMMENTS AND PROTESTS ON PETITION FOR DECLARATORY ORDER**

I. INTRODUCTION

On May 13, 2005, the California Independent System Operator Corporation (“CAISO”)¹ filed with the Commission a Petition for Declaratory Order (“Petition”) requesting a finding that changes to the selection process for the CAISO Board of Governors (“Board”) recently adopted by the Board result in a CAISO governance structure that is acceptable to the Commission. In response to the Petition, several parties submitted comments and/or protests.²

Pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213, the CAISO hereby requests leave to file an answer, and files its answer, to the comments and protests in the above-referenced dockets. To the extent that this filing responds to pleadings

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

² Comments and/or protests on the Petition were submitted by the California Municipal Utilities Association (“CMUA”), the California Electricity Oversight Board (“EOB”), the Independent Energy Producers Association and the Western Power Trading Forum (“IEPA/WPTF”), the Metropolitan Water District (“MWD”), and the Sacramento Municipal Utility District (“SMUD”).

styled as protests, the CAISO requests waiver of Rule 213 (18 C.F.R. § 385.213) to permit it to make this answer. Good cause for this waiver exists here given the nature of this proceeding and the usefulness of this Answer in ensuring the development of a complete record. See, e.g., *Enron Corp.*, 78 FERC ¶ 61,179, at 61,733, 61,741 (1997); *El Paso Electric Co.*, 68 FERC ¶ 61,181, at 61,899 & n.57 (1994). As explained below, the CAISO believes that the Commission should grant the Petition, and that the relief requested in the various comments and protests submitted in response to the Petition should be denied.

II. ANSWER

A. The Fact that the Governor of California Continues to Retain Final Discretion in Making Appointments to the CAISO Board Does Not Suggest that the Petition Should Be Denied

Several parties contend that the CAISO's selection process does not change the nature of the Commission's conclusions concerning the CAISO's independence because the Governor of California still retains the ultimate selection authority with respect to Board candidates. CMUA at 6-7; IEPA/WPTF at 4-5; SMUD at 3-4. This argument is unconvincing.

The Commission never concluded that the fact that the Governor had the ultimate authority to appoint Board candidates was, in and of itself, fatal to the CAISO's independence. Rather, the Commission, in its July 17, 2002 "Order Concerning Governance of the California Independent System Operator Corporation," 100 FERC ¶ 61,059 (2002) ("Governance Order"), indicated that it desired a CAISO governance structure free from undue stakeholder influence, consistent with the principles expressed in Order Nos. 888 and 2000, and

comprised of candidates with appropriate expertise. With respect to the matter of undue influence, the Commission indicated that the primary problem with State selection of the Board was the fact that CDWR had become a major market participant in the CAISO's markets by virtue of its "substantial purchases of electric energy . . . on behalf of the [Investor Owned Utilities ("IOUs)]." Governance Order at P 57. The Commission also noted its objection to the presence on the Board of two employees of organizations representing end-users. *Id.* at P 59. As indicated in the Petition, CDWR is no longer a substantial purchaser of electric energy on behalf of the IOUs. Moreover, as explained below, the long-term contracts entered into by CDWR with various suppliers do not sufficiently impact the CAISO's Markets, such that CDWR should be considered a major market participant in those Markets. In addition, the two members of the Board with respect to which the Commission expressed particular concern in the Governance Order are no longer on the Board.

Despite the fact that the Governor still retains ultimate selection authority with respect to Board candidates, the CAISO's new selection process represents a significant step towards satisfying the Commission's concerns with respect to CAISO governance. The selection process will do much to ensure that the CAISO Board is both free from undue stakeholder influence and comprised of members with appropriate expertise, while also incorporating broader stakeholder participation in the selection process, a feature of the selection process articulated by the Commission in the Governance Order. It stands to reason that the Governor will have a strong incentive to make appointments from

the list of recommended candidates, in order to make clear that the CAISO will be responsive to the needs of all of its participants as well as the needs of the public. The CAISO therefore believes that its recommendation process largely satisfies the concerns articulated by the Commission with respect to CAISO governance in the Governance Order, while working within the confines of both California State law, which obviously cannot be changed by CAISO fiat, and the D.C. Circuit's ruling that the Commission cannot dictate the CAISO's governance as a "term or condition" of jurisdictional service under the Federal Power Act.³ The CAISO submits that its recommendation process strikes a fair balance among state law, federal court precedent, and the Commission's expressed concerns with respect to the CAISO's governance structure, and that the fact that the Governor retains final selection authority does not, in and of itself, invalidate the substantial benefits provided by the CAISO's recommendation process. The CAISO thus respectfully urges the Commission to approve the Petition, so that the CAISO, its Participants, and the Commission, can move forward in several areas where the independence issue has hindered final resolution or the implementation of important initiatives.

B. The Long-Term Power Purchase Contracts Held by CDWR Do Not Make the State a Significant CAISO Market Participant, and the CAISO's Filing to Ensure the Compatibility of these Contracts with the CAISO's Market Redesign Process is Not Indicative of CAISO Favoritism towards CDWR

In the Petition, the CAISO explained that the State's role in the CAISO market, through CDWR, is substantially diminished from what it was at the time the Commission issued the Governance Order, because CDWR is no longer

³ *California Independent System Operator Corp. v. FERC*, 372 F.3d 395 (2004).

authorized to make energy purchases on behalf of the IOUs in California.

Petition at 14. Several parties, however, maintain that the State continues to be a significant participant in the CAISO markets for a different reason – *i.e.*, by virtue of the long-term power purchase contracts entered in by CDWR for energy to cover the net-short position of the IOUs – and that a recent CAISO filing to address the compatibility of these contracts with the CAISO’s proposed market redesign⁴ highlights a continued perception problem concerning the CAISO’s independence. CMUA at 5-6; IEPA/WPTF at 3-4; SMUD at 4-5.

Those accusations are patently false. First, the CAISO’s role with respect to these contracts is fundamentally different than its role with respect to the spot energy purchases made by CDWR on behalf of the net short load of the IOUs.⁵ Unlike the spot purchases made by CDWR, the capacity covered under the contracts is not transacted and settled through the CAISO Markets. The CAISO was not involved in negotiating these contracts, and has not been active in the litigation concerning possible reformation of these contracts. Rather, the CAISO’s role with respect to these contracts is primarily operational, relating to scheduling and the compatibility of the delivery provisions of these contracts with its market redesign proposal. Moreover, pursuant to orders issued by the California Public Utilities Commission (“CPUC”), scheduling under the CDWR contracts is now the responsibility of the IOUs, rather than CDWR. In a

⁴ Comprehensive Design Proposal for Inter-Scheduling Coordinator Trades, Docket No. ER02-1656-025 (March 15, 2005).

⁵ It is also worthwhile to note that the Commission, in the Governance Order, never identified the CDWR contracts as a source of concern. Rather, the Commission specifically focused on the spot purchases made by CDWR in the CAISO’s Markets. Governance Order at P 57.

September 19, 2002 decision,⁶ the CPUC allocated the various CDWR contracts among the three IOUs and made them responsible for performing all of the day-to-day scheduling and dispatch functions, including administrative functions, for the contracts allocated to their portfolios.

As for the CAISO's filing to harmonize these contracts with its market redesign effort (the "Inter-SC Trade Filing"), the parties raising this issue fail to mention that the main purpose of that filing was to facilitate a resolution of the concerns articulated by *the Commission* with respect to the treatment of certain of the CDWR contracts under the CAISO's proposed market redesign.⁷ The fact that the CAISO made the Inter-SC Trade Filing demonstrates nothing more than the CAISO's responsiveness to an already recognized problem with respect to the implementation of one of the primary components of its market redesign process, Locational Marginal Pricing ("LMP"). Indeed, the only commenter that even attempts to explain how the Inter-SC Trade Filing might be construed as a lack of independence is SMUD, which maintains that the filing shows favoritism towards CDWR, because, according to SMUD, it would resolve an incompatibility issue between the CDWR contracts and the market redesign process "at the expense of other ISO transmission customers." SMUD at 5. SMUD does not explain how the Inter-SC Trade Filing would harm "other ISO transmission customers," but the CAISO surmises that SMUD's characterization is a reference

⁶ Order Instituting Rulemaking to Establish Policies and Cost recovery Mechanism for Generation Procurement and Renewable Resource Development, R. 01-10-024 (Sept. 19, 2002).

⁷ See California Independent System Operator Corporation, Public Utilities Providing Service in California under Sellers' Choice Contracts, 107 FERC ¶ 61,274 at PP 165-66 (2004) ("June 17 Order"). In the June 17 Order, the Commission instituted a Section 206 proceeding to

to the various objections that it raised in its protest to the Inter-SC Trade Filing. These objections were rejected by the Commission in its recent order approving the Inter-SC Trade Filing, in which the Commission found that the CAISO's Inter-SC Trade Proposal is a "reasonable means to resolve the issues arising under [the CDWR] contracts and the transition of these contracts to LMP."⁸

For these reasons, the CAISO submits that the CDWR contracts do not make the state a significant CAISO Market Participant, and the Inter-SC Trade Filing is not indicative of any lack of CAISO independence or favoritism towards CDWR.

C. The Commission Should Address Issues Concerning Amendment No. 55 in That Proceeding, Rather than in the Current Docket

Two parties raise concerns with respect to issues that have arisen in the Amendment No. 55 proceeding, apparently based on the CAISO's footnote in the Petition stating that, upon receipt of a Declaratory Order finding that the CAISO's governance structure is acceptable to the Commission, the CAISO will file an amended Enforcement Protocol ("EP") indicating that the CAISO (rather than the Commission) will administer the provisions of that Protocol. Petition at 6, n. 12. CMUA argues that the Commission should resist any suggestion that all issues surrounding the EP would be resolved upon granting the Petition, and that, in light of the Commission's recent policy statement on Market Monitoring Units, a comprehensive review of the EP is necessary if the Petition is granted. CMUA at 7-8. IEPA/WPTF goes one step further, maintaining that the Commission should

investigate the feasibility of both upholding existing seller's choice contracts without modification and implementing the CAISO's proposed market redesign.

⁸ California Independent System Operator Corp., 111 FERC ¶ 62,384 (2005) at P 28.

continue in its role as the enforcer of the EP regardless of the independence of the Board. IEPA/WPTF at 5-7.

The CAISO submits that these issues are appropriately resolved in the ongoing Amendment No. 55 proceeding, rather than in the present docket. The CAISO's footnote concerning the filing of an amended EP was merely informational in nature. And, although the CAISO's statement was based on the Commission's explicit ruling in its February 20, 2004 order addressing Amendment No. 55,⁹ the CAISO understands that any filing made by the CAISO to amend the EP would need to be made in the Amendment No. 55 docket, and that the merits of such a filing would be addressed therein. The CAISO therefore urges the Commission, for purposes of its consideration of the Petition, to set aside comments concerning Amendment No. 55 issues, including those dealing with the proper roles of the CAISO and the Commission in enforcing the provisions of the EP.

D. The CAISO's Petition is Not Rendered Premature Because the Current Board Members Were Not Appointed Pursuant to the CAISO's Recommendation Process

Finally, several entities suggest that the Petition is premature, because the CAISO's current Board members were not selected pursuant to the CAISO's new recommendation process. CMUA at 4-5; MWD at 6-7; SMUD at 3-4. While it is obviously true that the CAISO's current Board was not selected pursuant to the new recommendation process, significantly, none of these parties suggest that any of the current Board members in any way fails to meet the qualifications proposed in the new process. In fact, several explicitly state the contrary. For

instance, SMUD states that it has “high regard” for the current Board members, SMUD at 3, and the CMUA notes that it does not allege that the current Board is biased. CMUA at 6. Moreover, in the Petition, the CAISO explained that none of the current members of the Board are affiliated with CAISO stakeholders, and that all have significant experience in relevant fields of expertise. Petition at 11-12. The CAISO’s recommendation process was intended to ensure that future Board candidates are of the same caliber as the current Board members, and so that Market Participants and the Commission can be assured of such, rather than having to revisit this issue with each subsequent iteration of Board membership. However, absent some showing that one or more of the current Board members are in some way unsuitable, the CAISO maintains that the mere fact that they were not appointed under the CAISO’s new recommendation process does not have any bearing on the Commission’s analysis of whether the CAISO has satisfied the Commission’s concerns with respect to CAISO governance.

⁹ California Independent System Operator Corp., 106 FERC ¶ 61,709 (2004).

III. CONCLUSION

For the foregoing reasons, the CAISO respectfully request that the Commission grant the Petition, and reject and comments or protests urging the contrary.

Respectfully Submitted,

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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 15th day of June, 2005 at Folsom in the State of California.

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