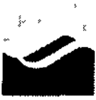


CALIFORNIA ISO

California Independent
System Operator

September 23, 2003

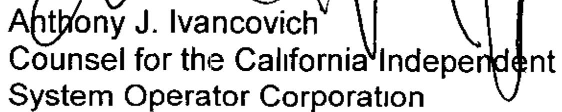
Magalie Roman Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E
Washington, D C 20426

Re: **California Independent System Operator Corporation, Docket No. ER03-1221-000**

Dear Secretary Salas

Enclosed please find an electronic filing in the above-captioned proceeding of the Answer of California Independent System Operator Corporation to Motions to Intervene, Comments, Protests, and Requests for Technical Conference Thank you for your attention to this filing.

Respectfully submitted,



Anthony J. Ivancovich
Counsel for the California Independent
System Operator Corporation

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))))	**Docket No. ER03-1221-000**

ANSWER OF
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTIONS TO INTERVENE, COMMENTS, PROTESTS, AND REQUESTS FOR TECHNICAL CONFERENCE

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. 385.213, the California Independent System Operator Corporation ("ISO")[1] respectfully submits its Answer to the Motions to Intervene, Comments, Protests and Requests for Technical Conference in the above identified docket The ISO recognizes that Rule 213(a)(2) prohibits answers to protests. The Commission has, however, accepted answers to protests that assist the Commission's understanding and resolution of the issues raised in a protest, *Long Island Lighting Co.*, 82 FERC ¶ 61,129 (1998), clarify matters under consideration, *Arizona Public Service Co.*, 82 FERC ¶ 61,132 (1998), *Tennessee Gas Pipeline Co.*, 82 FERC ¶ 61,045 (1998), or materially aid the Commission's disposition of a matter, *El Paso Natural Gas Co.*, 82 FERC ¶ 61,052 (1998). The ISO's Answer responds to protests only to the extent that the information provided will clarify matters under consideration, aid the Commission's understanding and resolution of the issues, or help the Commission to achieve a more accurate and complete record, and the

Commission should accordingly accept this Answer *Northern Border Pipeline Co.*, 81 FERC ¶ 61,402 (1997), *Hopkinton LNG Corp.*, 81 FERC ¶ 61,291 (1997). Because the ISO has attempted to restrict this Answer to information that meets the Commission's standards for acceptance of an Answer, the Commission should not construe the ISO's failure to address a comment or protest as agreement with the substance thereof

I. BACKGROUND

On August 18, 2003, the California Independent System Operator Corporation ("ISO") filed Amendment No 56 to the ISO Tariff. Amendment No. 56 seeks to reform provisions of the Tariff put in place in 2000 to address problems related to Dispatching and Scheduling RMR Units. Amendment No 26 authorized the ISO to "predispatch" RMR Units and set forth obligations to bid RMR Energy into the California Power Exchange ("PX") and established a process of notification, bidding and scheduling tied to PX timelines:

- Under the amendment, the ISO dispatched RMR Units prior to the close of the PX Day-Ahead Market, so that the RMR Unit could be scheduled in that market.
    - If the RMR Owner wished to take payment through the market and assume market risk – the Market Path, available only to "Condition 1" Units" – it could schedule a bilateral transaction or bid any amount into the PX Day-Ahead Market, as long as it ensured that the RMR Unit is scheduled against Demand in a bilateral transaction or a PX Market; and
    - If the RMR Owner wished to receive the payment specified in its RMR Contract,[2] – the Contract Path – the Owner had

[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff

to bid the Energy into the PX Day-Ahead Market at zero dollars, providing the greatest opportunity for the Energy to be Scheduled against Demand.

- The amendment ensured that the dispatched Energy is Scheduled against Demand by all but eliminating the ability of RMR Owners under the current RMR Contracts to skip the forward markets and take payment through the Real Time Market.[3]

Various aspects of these provisions became unworkable when the PX ceased operations in January 2001 Nonetheless, the ISO and RMR Owners have been able to operate under predispatch by substituting bilateral transactions for bids into the PX markets. Recently, however, RMR Owners affiliated with Mirant California, LLC, reported having difficulty Scheduling bilateral transactions to comply with the predispatch Scheduling requirements. Moreover, a recent Commission order indicated that one particular method for matching RMR Energy against Demand when bilateral transactions were not available – Scheduling against nonexistent ("dummy") Load to satisfy the ISO's Balanced Scheduled requirement – could constitute a violation of the ISO's Market Monitoring and Information Protocol. Prompted by the concerns of the Mirant RMR Owners, Commission staff held a technical conference to discuss remedies for these problems. At the conference, in response to the expressed concerns and guided by what it believed to be a consensus on general principles, the ISO pledged to file Tariff changes proposing a way to retain the operational

[2] Under such circumstances, the Participating Transmission Owner that is the Responsible Utility ("RU"), has, in effect, bought the Energy through the ISO to serve demand that, because of system conditions, cannot be served by other Resources Because this Demand is thus already being served, it must be "netted out" of the PX Day-Ahead Market

[3] Only if there was insufficient Demand in either the PX Day-Ahead or "Day-Of" markets to balance the RMR Energy could the RMR Energy go into real time un-Scheduled

and contractual benefits of the predispatch provisions but address problems described by Mirant.

Amendment No. 56 was intended to fulfill that pledge. It would require and RMR Owner to Schedule its RMR Contract Energy against the Demand of the Utility Distribution Company affiliated with the Responsible Utility (the "Applicable UDC" via an Inter-Scheduling Coordinator ("Inter-SC") Energy trade between the Scheduling Coordinator for the RMR Owner and the Scheduling Coordinator for the Utility Distribution Company affiliated with the Responsible Utility (the "Applicable UDC SC") To address another problem created by the demise of the PX – the loss of a transparent price for valuing the "market value" of the RMR Energy -- this Inter-SC trade would be deemed to take place at $0/MWh for the purposes of determining the amount of the credit against the RMR Invoice [4]

[4] Under the Contract Path, the RMR Unit Owner must credit any amounts received under a bilateral contract (or from an auction market) against the amounts due it on the RMR Invoice When the PX existed, the PX Day-Ahead price was the credit-back price for RMR Energy on the Contract Path

On August 21, 2003, the Commission issued a Notice of Filing in the above-captioned proceeding. Numerous parties filed motions to intervene in this proceeding, many accompanied with comments, protests, or requests for hearing.[5]

II. RESPONSE MOTIONS TO INTERVENE

The ISO does not oppose any of the Motions to Intervene filed in this docket

III. RESPONSE TO PROTEST, COMMENTS, AND REQUESTS FOR TECHNICAL CONFERENCE

A. GENERAL COMMENTS

The Commission's review of Amendment No 56, of the protests and comments thereto, and of this Answer, should be informed by the market deficiencies that gave rise to Amendment No. 26. Specifically, the inability to predispatch RMR Energy produced the following adverse effects:

- Increased flows of Energy into real time and imperfect shifting of Demand into real time in order to take advantage of that increased real time Energy increased the volatility of the Real Time Market
- More frequent adjustments of schedules in real time reduced the ability of Scheduling Coordinators to schedule resources optimally.

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[5] Motions to Intervene that raised no substantive issues were filed by the Automated Power Exchange, California Electricity Oversight Board, California Municipal Utilities Association, Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California, Independent Energy Producers Association, NRG Power Marketing, Inc and NEO California LLC, Northern California Power Agency, and the Turlock Irrigation District The California Public Utilities Commission filed a Notice of Intervention and comments regarding the retail rate treatment of the RMR Energy purchased by a UDC Motions to Intervene and Comments or Protests were filed by California Department of Water Resources – State Water Project, Duke Energy North America LLC and Duke Energy Trading and Marketing, L L C (together, "Duke"), Dynegy Power Marketing, Inc , El Segundo Power, LLC, Long Beach Generation LLC, Cabrillo Power I LLC, and Cabrillo Power II LLC (together, "Dynegy"), Metropolitan Water District of Southern California ("MWD"), Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC (together, "Mirant"), Pacific Gas and Electric Company ("PG&E"), Reliant Energy Services ("Reliant"), Sempra Energy ("Sempra"), Southern California Edison Company ("Edison"), Williams Power Company, Inc ("Williams")

- Higher volatility in real time Demand also raised reliability risks.

- The inclusion in the PX Day-Ahead Market of Demand that, due to system conditions, could only be met by RMR Units that were not scheduled in that market, lead to overstatement of Demand and increased prices in those markets.

- The pre-Amendment No 26 RMR dispatch procedures created incentives for some RMR Owners to forego the PX Day-Ahead Market under certain circumstances, producing a greater incidence of overstated Demand in that market

The need to avoid such market deficiencies has not changed. The Commission should avoid under all circumstances any solution to the difficulties reported by Mirant that resurrects the conditions that existed prior to Amendment No. 26

Indeed, the situation that has existed since the demise of the PX is preferable to the recommendations of some parties. From the ISO's perspective, the only significant drawbacks of the status quo are that (1) the bilateral sales of RMR Energy lack transparency, calling the amounts credited back on the RMR invoice into question, and (2) to the extent that some Scheduling Coordinators Schedule dummy Load to balance their RMR Energy, the fact that such Load does not really exist creates oversupply conditions that the ISO must address in real time. Ultimately, however, the lack of transparency on the amounts credited back is not an operational issue of concern to the ISO, but a financial issue that should be of concern to the Responsible Utilities. Though the improper Scheduling of dummy Load is, in contrast, an operational issue, it is also already a violation of the ISO's MMIP Moreover, once the ISO implements forward

Energy Markets as contemplated in its market redesign, the difficulties presented by the demise of the PX will disappear.

The ISO thus offered Amendment No. 56 not because of an urgent need for reform, but only as a result of the technical conference convened by staff to address difficulties allegedly encountered by the Mirant RMR Owners in arranging bilateral transactions. Like other parties at the technical conference, the ISO remains unclear about the source of the difficulties. No party argued that credit problems would affect an RMR Owner's ability to *sell* Energy, and because its costs are already covered by the RMR Contract, the RMR Owner can certainly underbid any seller other than another RMR Owner if and when it seeks to sell that same Energy through a bilateral contract. It is true that, by selling the RMR Contract Energy, the RMR Owner might miss an opportunity to sell the same amount of Energy from some other units on which it would make a profit, but that is a choice that an RMR Owner makes when it chooses the Contract Path or Condition 2. Such RMR Owners already have a guarantee of receiving their costs from the Responsible Utility under the RMR Contract An Owner that does not want to forego market opportunities for its RMR Energy can and should elect Condition 1 and choose the "Market Option" for its RMR Energy, under which it can retain all profits from those sales. RMR Units under Condition 2 (or that have chosen the Contract Path) and the Demand that is served by the essential reliability Energy they produce are not, by the Owner's own election, in the market. Generating Units that are in the market must compete for the remaining Demand

The ISO therefore urges the Commission carefully to weigh the benefits of forward Scheduling of RMR Contract Energy against the scope of the problems raised by RMR Owners in its evaluation of Amendment No 56.

B. SPECIFIC RESPONSES

The vast majority of the time at the technical conference was devoted to working out a compromise between Mirant, whose problems prompted the technical conference, and PG&E, the Participating TO that is the Responsible Utility for Mirant's RMR Units and the UDC that the ISO recommended as the logical party against whose Demand Mirant's RMR Energy should be Scheduled, without sacrificing the benefits of forward Scheduling. Despite those efforts – and what appeared to the ISO parties to be general agreement at the end of the conference on the way to address this problem -- both Mirant and PG&E now recommend that the Commission reject Amendment No. 56 outright

Both Mirant and PG&E justify their opposition in part by accusing the ISO of failing to adequately address the Scheduling of RMR Energy under the Contract Path with interested stakeholders following the demise of the PX. The ISO disagrees strenuously with these accusations, but is not going to waste the Commission's time engaging these arguments because they have no bearing on the merits of Amendment No 56.

The thrust of Mirant's primary argument is that the Commission should simply tolerate the practice of scheduling against dummy Load. Mirant first contends that, because Amendment No 56 would waive underscheduling penalties when the Applicable UDC has made commercially reasonable efforts to schedule the RMR Energy but has been unable to do so, the ISO is apparently

willing to tolerate scheduling against dummy Load by UDCs but not by RMR Owners. Mirant contends that the ISO should trust it to make every effort to schedule its RMR Energy against Load because it has an incentive to avoid a negative effect on real time Energy prices. While Mirant's admission that they have Scheduled dummy Load to balance RMR Energy calls this incentive into question[6] it is also beside the point because Mirant ignores a number of significant distinctions First, PG&E, during the technical conference, was willing to accept the responsibility to find Demand against which to schedule the Energy, subject to a commercially reasonable efforts standard, the only dispute involved the burden of proof regarding such efforts. Second, and more important, PG&E, as a UDC, has native Load against which to schedule the RMR Energy RMR Owners are generally not similarly situated

Mirant's solution would simply return the ISO to the circumstances that existed before Amendment No 26. Scheduling RMR Energy against dummy Load is operationally no different than not Scheduling RMR Energy at all. Either way, the RMR Energy shows up in real time unmatched against Demand. Either approach produces all of the market and reliability deficiencies that prompted the ISO to submit and the Commission to approve Amendment No. 26 Mirant came to the Commission complaining that it could not schedule its RMR Energy – the task therefore is to find someone that can.

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[6] Mirant's argument is based on the premise that forward scheduling against dummy load decreases the real time price of Energy, since the dummy load never shows up in the real time, leading to oversupply in real time This practice, however, also artificially increases the forward prices of Energy by (artificially) increasing the Demand to be served by the available Generation, as Mirant recognizes, Whether Mirant is financially better served by higher prices in the forward markets or in the real time markets, which recently have been dominated by decremental Energy bids, depends on the particular economics of Mirant's units

PG&E, in contrast, asserts that RMR Owners should be held to their responsibility to sell the RMR Energy The ISO is sympathetic to this position. Under the circumstances presented by Mirant, however, this does not appear to be a practical resolution. Given Mirant's purported inability to sell and Schedule the RMR Energy, the Applicable UDC is simply the most logical entity to absorb the RMR Energy In this instance, PG&E/Responsible Utility, is already paying for the RMR Contract Energy, and is passing the cost on to its retail and wholesale transmission customers, the vast majority of whom are served by PG&E/Applicable UDC It only seems to make sense that, under Amendment No 56, PG&E/Applicable UDC should be receiving the RMR Energy for free

Moreover, for decades before the formation of the ISO, PG&E's Demand was able to absorb the RMR Energy from these RMR Units (albeit without the RMR designation) Although PG&E is now saddled with Department of Water Resources power contracts, its Demand has also grown considerably. The circumstances in which PG&E is unable to absorb or market the RMR Contract Energy – which, at $0/MWh, is very marketable – should be rare indeed.

All of these considerations argue equally against PG&E's suggestion that the RMR Energy should be allocated to all Scheduling Coordinators In particular, allocating the Mirant RMR Contract Energy to PG&E is also consistent with the fact that the need for these Mirant's RMR Units arises from the reliability requirements of PG&E's transmission system. Until forward markets are available, the Applicable UDC provides the logical Load for RMR Energy.

Other parties, while not going so far as PG&E, would retain the possibility of matching RMR Contract Energy to Load through bilateral transactions. Dynegy and Williams recommend that RMR Owners choosing the Contract Option retain the option to sell the RMR Energy under a bilateral transaction and schedule it either Day-Ahead or Hour-Ahead. Edison and Sempra similarly suggest that the RMR Owner be allowed to make an annual choice between the sale of RMR Energy under bilateral transactions and Inter-SC trades with the Applicable UDC SC Although, as discussed above, the ISO acknowledges that bilateral transactions have operated as a reasonable Scheduling substitute for the PX Markets since the demise of the PX and is not entirely clear about the problems encountered by Mirant, the ISO nonetheless believes that the methods proposed in Amendment No. 56 are preferable to bilateral transactions By mandating Inter-SC trades and valuing the credit back amount of those Inter-SC trades at $0/MWh,[7] Amendment No 56 provides transparency as to the market value of the RMR Energy. With a bilateral transaction, the ISO has no assurance that the amount reported on the RMR invoice reflects the amount received for the RMR Energy.[8] This should be of particular importance to Responsible Utilities, or

[7] The ISO initially proposed that the price of the inter-SC trade be established at $0/MWh, but, at the request of certain Market Participants, modified the proposal to specify that the Inter-SC trade be valued at $0/MWh for the purposes of the credit on the RMR invoice Because the Responsible Utility that benefits from the credit on the RMR invoice is affiliated with the Applicable UDC that purchases the Energy, however, the ISO expects that the actual value of the Inter-SC Trade will approximate $0/MWh

[8] As the Commission may recall, the difficulty with verifying that RMR Owners credit back the market value of RMR Energy is why the original "B" RMR Contract – in which an RMR Owner received full fixed cost recovery but was required to credit back 90% of their market profits – was abandoned

potential Responsible Utilities, such as Edison, Sempra, and PG&E From the ISO's perspective, transparency is preferable because it avoids disputes

Edison and Sempra point to problems that may result from potential differences between the market value of the Inter-SC trade and the $0/MWh valuation for the credit against the RMR Invoice. They request a technical conference to resolve such issues. The ISO had originally proposed that the Inter-SC trade be given a market value of $0/MWh or the Market Clearing Price, not solely for the purpose of the credit against the RMR Invoice; the ISO modified Amendment No. 56 so that the $0/MWh price applied only to the credit-back provisions of the RMR Contract at the request of interested parties. Assigning a specific market value to the Inter-SC trade could resolve some issues regarding the determination of commercially reasonable efforts and avoids the need for a technical conference. The ISO urges the Commission to resolve this matter in a manner that provides clarity and certainty to the markets.

PG&E also complains that the Amendment No. 56 places the burden on it to demonstrate that it has made commercially reasonable efforts to schedule the RMR Energy in order to avoid penalties and charges for underscheduling. PG&E appears to misread Amendment No 56. As explained in the transmittal letter, Amendment No. 56 treats penalties and charges differently Under proposed Section 2 2.12.2.2 1, following each month,[9] PG&E need only inform the ISO of

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[9] PG&E correctly notes that the ISO has agreed that the schedule for submitting the information should be revised so that (i) for the first fifteen calendar days of each month, the Applicable UDC SC will provide the required data about its unmatched RMR Contract Energy for that period within fifteen days of the end of that period and (ii) for the remaining calendar days of each month, the Applicable UDC SC will provide the required data within fifteen days of the end of the month

the amount of RMR Contract Energy that could not be matched with Demand, and the ISO will take that amount into account in determining any penalties prior to issuing settlement statements. PG&E's only responsibility is to retain the necessary records of its commercially reasonably efforts.

Charges, however, are in a different category for the simple reason, as also explained in the transmittal letter, that the ISO is not aware of any charges that might reasonably arise from an inability to schedule RMR Contract Energy against Load [10] Under such circumstances, the only logical course of action is to rely upon the Applicable UDC SC to bring any such charges to the ISO's attention

The ISO does not disagree with Reliant's contention that overscheduling penalties should be waived only in connection with RMR Energy The ISO believes that this is the clear purpose of Section 2 2 12.2.2.1. The ISO does not believe, however, that any purpose is served by insisting that particular Load points be assigned for the overscheduling of RMR Contract Energy or that all overscheduling should be posted on the ISO's OASIS. To minimize potential effects under the current zonal congestion management model, the ISO expects that any dummy Load be Scheduled in the Zone containing the UDC's Load, or, at least, the majority of the UDC's Load. Proposed Section 2.2 12.2.2.1 represents an appropriate balance between the need for information and the avoidance of excessive burdens

[10] For the same reason, the ISO determined that it was unwilling to "exempt" Applicable UDCs from charges

Dynegy objects to Amendment 56's modification of the timeline regarding an RMR Owner's selection of the Market Option or Contract Option The ISO proposed this modification as an accommodation to PG&E, as part of a compromise solution to the problems presented by Mirant; a compromise that PG&E now asks the Commission to reject. The ISO has no stake in the modification of the timeline, except to ensure that the ISO has sufficient time to perform the additional duties required of it (i e., obtain and pass on the amount of RMR Contract Energy from each RMR Owner to the Applicable UDC SC) and simply urges the Commission to give full consideration to the competing interests

MWD indicates that is does not oppose Amendment No. 56 if the ISO appropriately predispatches RMR Energy. It is concerned, however, that the ISO has not provided sufficient information regarding its predispatch of RMR Units To the extent the Commission, or MWD, requires additional information on predispatch, the ISO notes that such information was provided with Amendment Nos 26, 35, and 37 and to the ISO Governing Board in public session on February 14, 2001 It is also available on the ISO website at http //www.caiso com/docs/2001/02/13/2001021315430722578 pdf, http //www.caiso.com/docs/09003a6080/0c/af/09003a60800cafd7.pdf, and http //www.caiso com/docs/09003a6080/0c/04/09003a60800c0420 pdf.

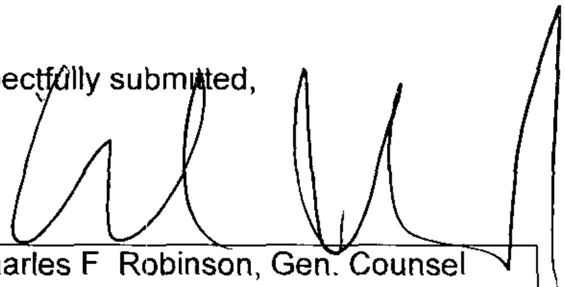
Duke seeks clarification of how the ISO will handle forced outages or derates after RMR Energy has been incorporated in final Day Ahead Schedules

This is not a matter affected by Amendment No 56 [11] Nonetheless, the ISO notes that the Scheduling Coordinator for the RMR Owner that does not deliver RMR Energy as scheduled will be responsible for Imbalance Energy costs to replace the Scheduled Energy that was not delivered and the RMR Owner will receive a reduced Availability Payment under the RMR Contract.

[11] Similarly, Duke's issues concerning predispatching RMR Energy on weekends do not implicate Amendment No 56

Finally, the ISO notes PG&E's request for ISO Tariff provisions indicating that nothing in the ISO Tariff would preclude an Applicable UDC from including the RMR Contract Energy as part of its reserves for the purpose of meeting Western Electricity Coordinating Council ("WECC") criteria. Nothing in the ISO precludes PG&E, or any Applicable UDC, from doing so. It is not the practice of the ISO, however, to include in the ISO any efforts to dictate WECC criteria, and the ISO believes it would be inadvisable to establish such a precedent.

Respectfully submitted,



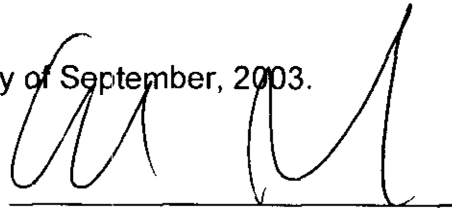
J Phillip Jordan Michael E. Ward Swidler Berlin Shereff Friedman, LLP 3000 K Street, N W , Suite 300 Washington, D C. 20007 Tel: (202) 424-7500 Fax: (202) 424-7643 Counsel for the California Independent System Operator Corporation	Charles F Robinson, Gen. Counsel Anthony Ivancovich, Reg Counsel The California Independent System Operator Corporation 151 Blue Ravine Road Folsom, CA 95630 Tel (916) 608-7135 Fax: (916) 351-4436

Dated. September 23, 2003

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F R § 385 2010).

Dated at Folsom, California this 23rd day of September, 2003.



Anthony J. Ivancovich