BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Consider)	
Refinements to and Further Development of the)	R.05-12-013
Commission's Resource Adequacy)	
Requirements Program)	
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REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON THE LOCAL RESOURCE ADEQUACY REQUIREMENT PHASE 1 STAFF REPORT

Facsimile:

Charles F. Robinson
Vice President and General Counsel
Grant A. Rosenblum
Regulatory Counsel
California Independent System Operator
151 Blue Ravine Road
Folsom, CA 95630
Telephone: 916-351-4400

Attorneys for the **California Independent System Operator**

916-351-2350

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In accordance with the scheduled established by Administrative Law Judge Wetzell, the California Independent System Operator Corporation ("CAISO") respectfully submits the following reply comments on the Local Resource Adequacy Requirement Phase 1 Staff Report, dated April 10, 2006. The CAISO is not responding to all of the comments filed in this docket, but rather identifying certain areas of agreement or disagreement with some of the parties.

I. LOCAL RESOURCE ADEQUACY REQUIREMENTS

I.A. Local Capacity Requirements

The CAISO's comments on this topic are set forth in its 2007 Local Capacity Technical Analysis, dated April 21, 2006. Moreover, the CAISO is filing, concurrent with these comments, an updated study based on the input received from the workshop held at the CAISO on April 26, 2006 to explain the study findings.

I.B. Local RAR

I.B.1 Adoption of a Local RAR Annually

The CAISO continues to urge the Commission to reconsider the Staff recommendation that a Local RAR proceeding be conducted annually. As explained in the initial comments, once the methodology for conducting the LCR studies has been established and approved in the context of this docket, there is no need to open an OIR to investigate that methodology each year. Rather, a multi-year study can be provided on an annual basis with any necessary "true-up" to make sure that the appropriate RAR requirement is established for the upcoming year and future years of the study period. Various parties have taken a similar position and have also pointed out that a multi-year process would add to regulatory stability. The CAISO agrees that a multi-year Local RAR process will promote longer-term contracting and infrastructure development as well as promote a more efficient use of resources for all parties involved.

I.B.2 Allocation of Local RAR to CPUC Jurisdictional LSEs

The CAISO has no further comments on this section.

I.B.3 Load Forecasting and Assignment Notification of Local RAR The CAISO has no further comments on this section.

I.B.4 Aggregation of Local Areas

In its opening comments, the CAISO expressed concerns regarding the possibility of "unnecessary" procurement due to the aggregation of the Local RAR by IOU distribution area. In other words, the Staff's recommendation could result in the correct number of MWs procured in aggregate, but in the wrong places. Other parties have raised similar concerns that a lack of procurement in certain areas could lead to higher backstop procurement by the CAISO, thus outweighing the administrative practicalities

Comments of Mirant California, LLC, et. al., p. 2; Comments of Independent Generators Association, 3.

associated with aggregating the local areas by IOU distribution area.² Thus, the CAISO agrees with issues raised by PG&E³ and would encourage the Commission to consider some restriction on the number of MWs LSEs can procure in any one local area that make up the IOU distribution area.

I.B.5 Compliance Demonstration for Local RAR

The CAISO generally supports the Staff's recommendation on this issue and has no reply comments.

I.B.6 Counting Resources for Local RAR

The Commission should clarify whether or not there will be a monthly showing requirement for the Local RAR. The CAISO believes the Local RAR should be an annual demonstration. The CAISO is in agreement with SCE's position that an LSE may not sell capacity during the periods in which the capacity is reflected in the LSE's Local RAR demonstration....Otherwise, the annual Local RAR demonstration process could be rendered meaningless if LSEs can subsequently sell their Local RA capacity and not make it available to the CAISO."4,5

a) Counting Reliability Must Run (RMR) Condition 1 and Condition 2 Resources for Local RAR

As previously stated, the CAISO wants to see an established annual Local RAR demonstration and the replacement of RMR with a single backstop procurement

Comments of Constellation Energy Commodities Group, et. al., 6

Comments of Pacific Gas and Electric Company (U 39 E) on Phase 1 Workshop Report Issues, 4.5.

⁴ Comments of Southern California Edison Company (U 338-E) On Advisory Staff Workshop Report, 21 Apr 06, p. 2.

PG&E also effectively captures this point in their comments that "the LSE must uphold its obligation for the full extent and period identified in the demonstration, and not sell, trade, default, or otherwise undermine the intended availability of the resource; Comments of PG&E (U 39 E) On Phase 1 Workshop Report Issues, 21 Apr. 06, p. 7.

methodology by 2008. TURN, in its comments, addresses the practical reality and difficulty of "crediting" RMR capacity due to the fact that "RMR contracts will not yet be determined at that point," i.e. before LSEs must produce their year-ahead showings.

This is a conundrum and it cannot be remedied by the CAISO "fast tracking" the RMR process. The CAISO is unable to "fast track" the RMR process because the timeline is dictated by the terms of the Pro Forma Must-Run Service Agreement ("RMR Agreement") which is further predicated on established FERC filing timelines. Thus there is no practical way to alter the RMR timeline because any delay, even if all parties to the RMR Agreement agreed to different terms related to process and timing (an improbable outcome in itself), would create a situation in which parties to the RMR Agreement are unable to comply with FERC rules and regulations for filing their rates.

Presented with this challenge, the CAISO suggests that one possible solution provides a reasonable balance to the timing issues and enables benefits to all parties. The critical timing problem is finding a means to enable the CAISO to incorporate RA designated units into the RMR designation process. The CAISO believes the Commission should consider an acceleration of the year ahead reporting deadline by one week to allow the CAISO to fully consider the procurement results of LSEs prior to making RMR designations. Thus, in 2006, the Commission would move its year-ahead RAR showing to the week prior to October 1st, i.e. to September 25, 2006, which will result in the RMR process better coordinating with the Commission's RAR program.⁷

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Post Workshop Opening Comments of The Utility Reform Network, 21 Apr. 06, p. 11.

The Pro Forma Must-Run Service Agreement Section 2.1 (b) states the "ISO may extend the term of this Agreement for an additional calendar year as to one or more Unit by notice given not later than October 1 of the expiring Contract Year." To accommodate the RMR Agreement extension requirement, the CPUC's year-ahead Local RAR showing would need to occur on or before September 25, 2006 rather than the proposed Oct 2, 2006 showing date.

Every September, the CAISO Board grants the CAISO the authority to extend existing RMR contracts and/or sign new RMR contracts. Per the RMR Agreement, the CAISO must notify owners of existing and newly designated RMR resources by no later than October 1st. This provides the RMR owner one month to prepare their FERC filings due by November 1st, and allows FERC 60-days to rule for a January 1st implementation. By moving the year-ahead showing to one-week prior to October 1st, the CAISO would have time to consider and incorporate those units with an RA designation before committing to an RMR contract.

To further coordinate the CAISO RMR process with the Commission RAR program, the CAISO would propose the following clarifying points for LSEs to use in meeting the CPUC requirements:

For Local RAR:

All RMR resources count toward the Local RAR for 2007.⁸
 However, LSEs will need to reflect additional resources to ensure they are meeting System RAR requirements.

At the Year-ahead System RAR showing:

• RMR resources do not count toward the System RAR (thus not incorporated as part of 90% demonstration)⁹.

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It is important to note, as of the CPUC's year-ahead Local RAR showing date of October 2, 2006, the condition (Condition 1 or Condition 2) each RMR Unit will operate under is not known. Per the *Pro Forma Must-Run Service Agreement*, Section 3.2 (a)- "Owner may, from time to time, transfer from one Condition to the other Condition.... If transfer is to become effective at the beginning of a Contract Year, Owner shall provide ISO at least 30 days prior notice of the transfer. For a transfer to become effective at any other time, Owner shall give ISO notice at least 90 days prior to the transfer." Thus for the January 1st effective date, Owners must notify the CAISO of an intent to transfer between conditions by December 1st prior to the next contract year. This date is 60 days after the proposed year-ahead Local RAR showing date.

CAISO recommends not counting any RMR in the year ahead showing for two reasons: 1)
Condition 1 should not count absent an RA contract and it will not be possible to determine which
Condition Units will be operating under by the year-ahead showing date; 2) not counting any RMR
resources in the year-ahead time frame leaves open the possibility that a Condition 2 unit could transfer to
Condition 1 prior to the month-ahead showing date and, thus enter into an RA contract to count toward
meeting the final RAR.

At the Month-ahead System RAR showing:

 RMR units that have elected Condition 2 status may count toward System RAR¹⁰

Moving the year-ahead showing date ahead by one week to September 25, 2006, may help address PG&E's concern that "LSEs, seeking least cost means to meet their requirements, would thus be likely to procure less effective resources. Those less effective resources will not displace RMR contracts, as the CAISO will not have time to evaluate their effect prior to entering RMR contracts." Given the timing and sequencing of the CAISO's RMR process, by August 2006, LSEs should have a good indication of which units the CAISO proposes to designate as RMR resources. LSE's could then enter into a resource adequacy contract with any of these units up to the Commission's annual LCR demonstration date (proposed September 25, 2006). Such an advance of the showing date would allow the CAISO to consider the RA contracts prior to finalizing its determination to extend existing RMR Contracts by October 1, 2006, or execute new RMR contracts.

AReM finds the CAISO's rationale that RMR Condition 1 resources cannot be dispatched for System RAR is irrelevant.¹² CAISO is very concerned that AReM has taken general references to RMR and mischaracterized them in a manner that creates the potential for reliability deficiencies in the Commission's RAR program. For instance,

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By the month-ahead showing dates, the CAISO will know with certainty which Condition the RMR Units have elected for the applicable showing month. CAISO will know which units are designated Condition 1 vs. Condition 2 by either December 1st for January 1st or 90-days prior to a transfer to a different condition during any other month during the year. Thus the CAISO could inform the CPUC approximately 2-months prior to a month-ahead showing how many MWs in any PTO service territory is under RMR Condition 2. Such notice must be provided on a confidential basis pursuant to the non-disclosure agreement associated with the applicable RMR Agreement as required by Article IX of the First Stipulation and Agreement for RMR filed with FERC on April 2, 1999, in Docket No. ER98-441, et.al.

Comments of Pacific Gas and Electric Company (U 39 E) on Phase 1 Workshop Report Issues, 21

Opening Comments of the Alliance for Retail Energy Markets on the Energy Division Staff Workshop Report, 21 Apr. 06, p. 14.

AReM references Staff's statement, "[r]esources that count towards meeting Local RAR will also count towards meeting System RAR." The CAISO believes AReM has taken Staff's statement out of context and clearly does not understand the dispatch limitations imposed by the RMR Agreement on RMR units.

As the CAISO has previously stated, the RMR Agreement has inflexible dispatch rights. Taken from the RMR Agreement, an RMR Dispatch Notice for energy can only be issued for purposes of meeting local reliability needs or managing intra-zonal congestion. In addition, the CAISO may not issue an RMR Dispatch Notice to fill a need for imbalance energy.¹³ Clearly, RMR is an inferior product relative to what the CAISO expects from RA capacity and such dispatch limitations, as illustrated, are not contemplated for energy associated with RA capacity.

Finally, the CAISO proposes the respective regulatory agencies and stakeholders work to develop a backstop procurement methodology that will extend beyond 2007 and replace the need for RMR contracting in 2008 and thus eliminate the current misalignment between the functions of RMR and RA.

b) Dispatchable Demand-Response Resources

The CAISO concurs with Constellation's recommendation that if the Commission is going to count demand-response resources toward the Local RAR, then such resources must be dispatchable by the LSE by location.¹⁴

Per the Pro Forma Must-Run Service Agreement Section 4.1 (b) ISO's Right to Dispatch"[RMR] Dispatch Notices for Energy... shall be issued solely for purposes of meeting local reliability
needs or managing intra-zonal congestion... ISO may not issue a [RMR] Dispatch Notice to fill a need for
imbalance energy (emphasis added)." Also, per Section 3.1 (ii) Conditions Under Which Units Will
Operate- "A Unit under Condition 2 shall not participate in a Market Transaction when ISO has not issued
a Dispatch Notice for the Unit."

¹⁴ Comments of Constellation Commodities Group, et. al., 9

c) Distributed Generation (DG)

The CAISO has no further comments on this section.

d) Effectiveness Factors and Counting Resources Outside the Defined Local Area

The CAISO has addressed effectiveness factors in the 2007 LCR Study and in its initial comments and has no further comments regarding this issue.

I.B.7. Evaluation of Compliance Demonstrations and Actions Taken Due to Non-Compliance with Local RAR

a) CAISO Evaluation

The respective roles of the CAISO and the Commission relative to grid reliability and service reliability were discussed in the CAISO's initial comments and the 2007 LCR Study, and no further comments are required on this topic. While some commenting parties had continuing concerns about the level of CAISO backstop procurement, such backstop procurement measures will be taken only to achieve Applicable Reliability Criteria consistent with the level of service reliability established by the Commission.

b) CPUC Evaluation

The CAISO has no further comments on this section.

I.B.8. Joint IOU's Transfer Payment Proposal

If SCE's statement has been interpreted correctly, the CAISO could not support SCE's position that the local area attribute would count towards an LSE's System RAR.¹⁵ The CAISO supports the local area attribute counting toward the Local RAR but not the

Comments of Southern California Edison Company (U 338-E) On Advisory Staff Workshop Report,

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System RAR. The conveyance of the local area attribute does not parlay into physical capacity. An over-procured LSE in a particular local area is likely counting on the "over-procured" capacity to satisfy its own System RAR and, therefore, the CAISO would be concerned about possible double counting. The transfer of the local area attribute merely allows an LSE to procure its total RAR from anywhere within the system, but it in no way lowers the LSE's System RAR obligation or eliminate the need to buy physical capacity to satisfy the System RAR. Therefore, to count for System RAR, LSEs would need to contract with physical resources, independent of the transfer of a local area attribute.

With the caveat noted above, the CAISO supports the concept of transfer payments as an interim mechanism until such time as market-based transfer mechanisms are developed. Other parties have expressed similar reservations.¹⁶

I.B.9. Enforcement and Penalties for Failure to Meet System or Local RAR Obligations

The CAISO agrees with TURN's position that a General Order ("G.O.") on RAR penalties may be untimely given a January 2007 implementation of the Local RAR. As such, the CAISO also would support the Commission's adoption of an interim Local RAR penalty that would be superseded by a final G.O. on RAR penalties.

I.B.10. Market Power

The CAISO has no further comments on this section.

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Mirant California, LLC., *et.al.*, note that: "It makes much more sense to effectively encourage bilateral transactions at this time and to focus resources on establishing a capacity market mechanism that can facilitate the kind of trading envisioned in the transfer payment proposal." *Comments of Mirant California, LLC. et. al.*, 7.

I.B.11. Waivers

As noted previously, the CAISO does not agree that a waiver process should be developed for many of the administrative reasons set forth in the Staff Report. Several parties have supported the notion that waivers be considered in a situation where an LSE is unable to meet its RAR requirements due to alleged market power. Under such circumstances, the deficient LSE, whether justified or not, will be allocated the cost of any necessary CAISO backstop procurement. Consequently, should the Commission consider waivers of any Commission-imposed penalties, the CAISO would again note that waivers should be granted on an "ex-ante" basis to the maximum extent possible.

II. TRADABLE CAPACITY PRODUCT

II.A. Workshop on March 27, 2006

II.A.1. Issue 1: Forced Outage Impact on Qualifying Capacity

Parties appear in general agreement as to the basic treatment of forced outages and the future role of the CAISO in establishing generator performance standards. However, the comments of WPTF and Mirant/NRG warrant particular emphasis and are consistent with comments the CAISO has previously submitted to the Commission. Both parties note that reliance on monthly, rather than annual, peak loads could negatively impact the effectiveness of the current RA program design. One such problem relates to accounting for scheduled outages.¹⁷

WPTF underscores that the Commission's adopted planning reserve margin "only account[s] for average forced outage rates, not scheduled outages." Accordingly, WPTF

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In addition to issues related to planned outages, Mirant/NRG notes that use of monthly peak loads may 1) result in consumers not getting their money's worth out of the capacity they buy and 2) increase the complexity, uncertainty, risk and associated costs of resource adequacy transactions. (Mirant/NRG at 11.)

notes that "since the reserve margin is based on a monthly peak load and scheduled outages almost exclusively occur in the off-peak months, the situation has arisen whereby insufficient capacity may be available to cover scheduled maintenance." (WPTF at 7.)

To accommodate this potential deficiency in available capacity, and the resulting need for the CAISO to resort to its backstop procurement, the CAISO previously petitioned to raise the non-summer planning reserve margin to 23%. The potential need to adjust for an off-peak season is especially justified given the increased variability in peak demand during shoulder months. Thus, the CAISO requests that the Commission remain open to evaluating the need to adjust the off-peak season planning reserve margin in 2007 based on the experience gained in 2006 and schedule this issue for a future phase of RAR development.

II.A.2. Issue 2: Derates and Qualifying Capacity

The CAISO has no further comments on this section.

II.A.3. Issue 3: Penalties for Non-Performance

The CAISO has no further comments on this section.

II.A.4. Issue 4: Maintenance and Repair Obligations

SCE notes that Commission G.O. 167 does not apply to all generators, but believes its "General Duty Standards for Operations and Maintenance" should be incorporated as the maintenance obligation common to all suppliers providing resource adequacy capacity under a standard product. (SCE at 14.) Constellation concurs that G.O. 167 sufficiently addresses concerns regarding generator maintenance. However, Constellation is unwilling to advocate extension of the G.O. 167 standards through the tradable capacity product to generators not otherwise subject to its provisions. Instead,

Constellation believes any "LSE with concerns about the maintenance or repair of the unit [should] seek to impose a requirement through bilateral contract." (Constellation at 18.) WPTF believes "good utility practice" under the CAISO Tariff and compliance with applicable laws, regulations and standards (e.g. FERC, NERC, and WECC standards). (WPTF at 13-14.) The effect of WPTF's formulation also appears to limit extension of G.O. 167 through the tradable capacity product to currently uncovered suppliers.

The CAISO does not support Constellation's suggestion. It is inconsistent with the creation of a uniform product and it may impair the liquidity of any standard product and the role of market intermediaries. If the Commission does elect to adopt the G.O. 167 standard as a standard contract provision, it should clarify that by selling capacity under the standard product, the supplier is not consenting to Commission jurisdiction over generators not otherwise subject to General Order 167.

II.A.5. Issue 5: Bulletin Board and Centralized Title Clearing

SCE notes that a title clearing mechanism will be important to address potential overselling of RA capacity and that incentives to procure oversold capacity, such as pro rata cuts, should not be adopted. The CAISO does not dispute the value of bulletin board or centralized title clearing mechanism in addressing SCE's concerns, but in the interim period the existence of a warranty in the contract that the capacity is not oversold should be sufficient. This is especially true if overselling of capacity not only leads to compensation from the generator to the LSE, but also is an event of default under the contract.

II.A.6. Issue 6: Clarity on Import Requirements

The total import capacity capable of allocation to California LSEs is a function of the physical characteristics of the integrated transmission grid. As such, the CAISO agrees with SCE that, to the extent the issues related to import allocation involve the relative capacity capable of being reserved for CPUC jurisdictional and non-jurisdictional LSEs, those issues are appropriately addressed in the context of the CAISO's pending FERC tariff filings. However, the CAISO readily acknowledges that its role in the initial determination process should be consistent, to the maximum extent possible, with the Commission's rules regarding long-term priorities, such as "evergreening." Therefore, the CAISO encourages the Commission refine the applicable rules, if necessary, at the earliest possible time in this proceeding.

II.A.7. Issue 7: Creditworthiness

The CAISO has no further comments on this section.

II.A.8. Issue 8: Intermediaries

The CAISO has no further comments on this section.

II.A.9. Issue 9: Pooling of Assets and Substitution

SCE and PG&E support the CAISO's general proposal regarding substitution. The CAISO agrees with PG&E's clarification that allowing unit substitution will affect the ability of the CAISO to evaluate efficacy of LSEs' aggregate local procurement in the year-ahead timeframe. Under the current understanding of the Local RAR proposal, only units identified in the CAISO's Local Capacity Technical Analysis as within a particular local capacity area will "count" towards satisfaction of the need for that local area. However, the CAISO will consider other units procured by LSEs outside the local

capacity area when reviewing the efficacy of the overall portfolio secured by LSEs for purposes of assessing the need, if any, for the CAISO to take reliability backstop procurement actions. As such, the CAISO agrees that the "busbar" rule for substitution is appropriate for local area resources and that substitution of system resources should be permitted up to the month-ahead showing for system resources, except for those system resources that the CAISO may have relied upon, and identified, as affecting its local reliability backstop assessment. Until a scope of potential system substitution is know, the CAISO agrees with SCE that such system substitution must be submitted to, and authorized by, the CAISO prior to the month-ahead showing. This should be accomplished at least 2 weeks prior to the date the month-ahead report is due.

WPTF commented in support of adopting the specific procedures for pooling assets employed by the NYISO to meet capacity requirements. The NYISO allows the creation of a "System Resource," which is defined as a portfolio of unforced capacity provided by resources in a single ISO-defined locality, i.e., Long-Island or New York City, or a single external control area. (See NYISO Installed Capacity Manual at § 4.10.) The Commission's current rules allow for a similar aggregation of resources located outside the CAISO Control Area. However, as noted in the TCP Report, the CAISO will consider pooling/portfolio resource adequacy resources in the context of its future MRTU design changes. Prior to MRTU, the CAISO cannot support WPTF's comments given the absence of an integrated day-ahead market, and the CAISO's current reliance of its Must-Offer Waiver Denial process to commit Net Qualifying Capacity from resource adequacy resources.

II.A.10. Issue 10: Regulatory Uncertainty

The CAISO has no further comments on this section.

III. IMPLEMENTATION ISSUES

III. A. Filing Guide and Templates

The CAISO has no further comments on this section.

III. B. Maximum Cumulative Capacity Buckets

The CAISO has no further comments on this section.

III. C. Accounting for Transmission Losses

The CAISO has no further comments on this section.

III. D. Process for Resolving Discrepancies

The CAISO has no further comments on this section.

CERTIFICATE OF SERVICE

I hereby certify that I have served, by electronic and United States mail, Reply Comments of The California Independent System Operator Corporation on the Local Resource Adequacy Requirement Phase 1 Staff Report in Docket No. R.05-12-013.

Executed on April 28, 2006, at Folsom, California.

Charity N. Wilson

An Employee of the California Independent System Operator

ARTHUR HAUBENSTOCK PACIFIC GAS AND ELECTRIC COMPANY ANDREW B. BROWN ELLISON, SCHNEIDER & HARRIS, LLP ADRIAN PYE ENERGY AMERICA, LLC ALAN COMNES WEST COAST POWER adrian.pye@na.centrica.com alan.comnes@nrgenergy.com AUDRA HARTMANN LS POWER DEVELOPMENT athartmann@duke-energy.com ANDREW ULMER CALIFORNIA DEPARTMENT OF WATER RESOURCE aulmer@water.ca.gov ANDREA WELLER STRATEGIC ENERGY, LLC aweller@sel.com FRANK ANNUNZIATO AMERICAN UTILITY NETWORK INC. allwazeready@aol.com Bishu Chatterjee CALIF PUBLIC UTILITIES COMMISSION bbc@cpuc.ca.gov BRIAN T. CRAGG GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP bcragg@gmssr.com BONNIE S. BLAIR BILL CHEN THOMPSON COBURN LLP CONSTELLATION NEWENERGY, INC. BOB ANDERSON APS ENERGY SERVICES Bob_Anderson@apses.com BRIAN K. CHERRY PACIFIC GAS AND ELECTRIC COMPANY BARRY F. MCCARTHY MCCARTHY & BERLIN, LLP CHARLES A. BRAUN BRAUN & BLAISING, P.C, bkc7@pge.com bmcc@mccarthvlaw.com braun@braunlegal.com BARBARA R. BARKOVICH BARKOVICH & YAP, INC. brbarkovich@earthlink.net BARRY R. FLYNN FLYNN RESOURCE CONSULTANTS, INC. brflynn@flynnrci.com BRIAN THEAKER WILLIAMS POWER COMPANY brian.theaker@williams.com HSI BANG TANG AZUSA LIGHT, POWER & WATER btang@ci.azusa.ca.us CASE ADMINISTRATION SOUTHERN CALIFORNIA EDISON COMPANY CHRIS RAPHAEL CALIFORNIA ENERGY MARKETS Charlyn A. Hook CALIF PUBLIC UTILITIES COMMISSION CALIFORNIA ENERGY MARKETS cem@newsdata.com chh@cpuc.ca.gov CONSTANCE PARR LENI CALIFORNIA ENERGY COMMISSION CURTIS KEBLER GOLDMAN, SACHS & CO. curtis.kebler@gs.com CHRISTOPHER J. MAYER MODESTO IRRIGATION DISTRICT CAROLYN KEHREIN ENERGY MANAGEMENT SERVICES cmkehrein@ems-ca.com chrism@mid.org Cleni@energy.state.ca.us DEBRA LLOYD CITY OF PALO ALTO debra.lloyd@cityofpaloalto.org DENNIS M.P. EHLING KIRKPATRICK & LOCKHART NICHOLSON GRAHAM dehling@king.com Donald J. Brooks DONALD BROOKHYSER CALIF PUBLIC UTILITIES COMMISSION dbr@cpuc.ca.gov ALCANTAR & KAHL LLP deb@a-klaw.com DON P. GARBER SAN DIEGO GAS AND ELECTRIC COMPANY DGarber@sempra.com DIANE I. FELLMAN Donna J. Hines CALIF PUBLIC UTILITIES COMMISSION DAVID X. KOLK COMPLETE ENERGY SERVICES INC FPL ENERGY, LLC diane_fellman@fpl.com dkolk@compenergy.com DOUGLAS MCFARLAN MIDWEST GENERATION EME dmcfarlan@mwgen.com DOUGLAS LARSON PACIFICORP doug.larson@pacificorp.com DANIEL W. DOUGLASS DOUGLASS & LIDDELL douglass@energyattorney.com DAVID MARCUS dmarcus2@sbcglobal.net DAVID A. SANDINO CALIFORNIA DEPARTMENT OF WATER RESOURCES dsandino@water.ca.gov ED CHANG FLYNN RESOURCE CONSULTANTS, INC. edchang@flynnrci.com DEVRA WANG DAVID WITHROW NATURAL RESOURCES DEFENSE COUNCIL dwang@nrdc.org CALIFORNIA ISO dwithrow@caiso.com E.J. WRIGHT OCCIDENTAL POWER SERVICES, INC. EVELYN KAHL ALCANTAR & KAHL, LLP ED LUCHA PACIFIC GAS AND ELECTRIC COMPANY Elizabeth Dorman CALIF PUBLIC UTILITIES COMMISSION edd@cpuc.ca.gov ej_wright@oxy.com ek@a-klaw.com ell5@pge.com LEGAL & REGULATORY DEPARTMENT CALIFORNIA ISO e-recipient@caiso.com EDWARD V. KURZ PACIFIC GAS AND ELECTRIC COMPANY evk1@pge.com VICKI E. FERGUSON BRAUN & BLAISING P.C. ferguson@braunlegal.com ERIC OLSON NAVIGANT CONSULTING INC. eolson@navigantconsulting.com MATTHEW FREEDMAN KAREN TERRANOVA FRED MASON GREG BASS SEMPRA ENERGY SOLUTIONS gbass@semprasolutions.com ALCANTAR & KAHL, LLP filings@a-klaw.com CITY OF BANNING fmason@ci.banning.ca.us THE UTILITY REFORM NETWORK GINA M. DIXON SAN DIEGO GAS & ELECTRIC COMPANY GREGORY T. BLUE DYNEGY INC. GRANT A. ROSENBLUM CALIFORNIA ISO CITY OF CORONA adixon@semprautilities.com george.hanson@ci.corona.ca.us greg.blue@dynegy.com grosenblum@caiso.com GRACE LIVINGSTON-NUNLEY PACIFIC GAS AND ELECTRIC COMPANY gxl2@pge.com MICHAEL WERNER CALIFORNIA DEPARTMENT OF WATER RESOURCES hcronin@water.ca.gov HOLLY B. CRONIN CALIFORNIA DEPARTMENT OF WATER RESOURCES hcronin@water.ca.gov HANK HARRIS CORAL POWER, LLC hharris@coral-energy.com

LILI SHAHRIARI AOL UTILITY CORP. ibbarrett@adelphia.net

JEFF LAM POWEREX CORP jeff.lam@powerex.com

JAMES MAYHEW MIRANT CORPORATION jim.mayhew@mirant.com

JANE E. LUCKHARDT DOWNEY BRAND LLP iluckhardt@downevbrand.com

imathis@edisonmission.com

IRENE K. MOOSEN irene@igc.org

ieffgrav@dwt.com

JEFFREY P. GRAY DAVIS WRIGHT TREMAINE, LLP

JOHN P. MATHIS EDISON MISSION ENERGY

REGULATORY & COGENERATION SERVICES, INC. jimross@r-c-s-inc.com

joe.como@sfgov.org

JAN REID COAST ECONOMIC CONSULTING

JESUS ARREDONDO NRG ENERGY INC. jesus.arredondo@nrgenergy.com

JOHN JENSEN

MOUNTAIN UTILITIES jjensen@kirkwood.com

JOSEPH PETER COMO CITY AND COUNTY OF SAN FRANCISCO

JOHN R. REDDING ARCTURUS ENERGY CONSULTING johnrredding@earthlink.net

JENNIFER CHAMBERLIN STRATEGIC ENERGY, LLC

jchamberlin@sel.com

JOHN GOODIN CALIFORNIA ISO

igoodin@caiso.com

JOHN W LESLIE

LUCE, FORWARD, HAMILTON & SCRIPPS, LLP jleslie@luce.com

JOHN PACHECO CALIFORNIA DEPARTMENT OF WATER RESOURCES jpacheco@water.ca.gov JANINE L. SCANCARELLI FOLGER LEVIN & KAHN LLP jscancarelli@flk.com

JEANNETTE OLKO

JOY A. WARREN MODESTO IRRIGATION DISTRICT joyw@mid.org

JAMES D. SQUERI GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP JAMES WEIL AGLET CONSUMER ALLIANCE KENNETH E. ABREU DAVIS WRIGHT TREMAINE LLP k.abreu@sbcglobal.net judypau@dwt.com KEONI ALMEIDA CALIFORNIA INDEPENDENT SYSTEM OPERATOR kalmeida@caiso.com KAREN A. LINDH LINDH & ASSOCIATES karen@klindh.com KATIE KAPLAN INDEPENDENT ENERGY PRODUCERS ASSOCIATION katie@iepa.com Kathryn Auriemma CALIF PUBLIC UTILITIES COMMISSION kdw@cpuc.ca.gov KEVIN BOUDREAUX CALPINE POWER AMERICA-CA, LLC kevin.boudreaux@calpine.com KEVIN WOODRUFF WOODRUFF EXPERT SERVICES KEITH MCCREA SUTHERLAND, ASBILL & BRENNAN KENNETH ABREU CALPINE CORPORATION kena@calpine.com KEITH JOHNSON CALIFORNIA INDEPENDENT SYSTEM OPERATOR KEVIN J. SIMONSEN ENERGY MANAGEMENT SERVICES GREGORY S.G. KLATT DOUGLASS & LIDDELL KIMBERLY KIENER IMPERIAL IRRIGATION DISTRICT kjohnson@caiso.com kisimonsen@ems-ca.com klatt@energyattorney.com kmkiener@iid.com Karen M. Shea CALIF PUBLIC UTILITIES COMMISSION kms@cpuc.ca.gov Karen P. Paull CALIF PUBLIC UTILITIES COMMISSION kpp@cpuc.ca.gov KRIS G. CHISHOI M. KEN SIMS CALIFORNIA ELECTRICITY OVERSIGHT BOARD kris.chisholm@eob.ca.gov SILICON VALLEY POWER ksims@siliconvalleypower.com LOS ANGELES DOCKET OFFICE CALIFORNIA PUBLIC UTILITIES COMMISSION LISA A. COTTLE WHITE & CASE, LLP LAURA GENAO SOUTHERN CALIFORNIA EDISON COMPANY Laurence Chaset
CALIF PUBLIC UTILITIES COMMISSION LISA WEINZIMER PLATTS lisa_weinzimer@platts.com DONALD C. LIDDELL DOUGLASS & LIDDELL LYNDA HARRIS
CALIFORNIA DEPARTMENT OF WATER RESOURCES LISA DECKER CONSTELLATION ENERGY GROUP, INC. lharris@water.ca.gov liddell@energyattomev.com lisa.decker@constellation.com LAWRENCE KOSTRZEWA LYNFILELLIND LYNN MARSHALL LYNN HAUG EDISON MISSION ENERGY kostrzewa@edisonmission.com COMMERCE ENERGY, INC llund@commerceenergy.com CALIFORNIA ENERGY COMMISSION Imarshal@energy.state.ca.us ELLISON, SCHNEIDER & HARRIS, LLP Imh@eslawfirm.com LYNN M. HAUG ELLISON & SCHNEIDER LEE TERRY
CALIFORNIA DEPARTMENT OF WATER RESOURCES LEEANNE UHLER MARIC MUNN UNIVERSITY OF CALIFORNIA CITY OF RIVERSIDE lmh@eslawfirm.com luhler@riversideca.gov maric.munn@ucop.edu MARK J. SMITH FPL ENERGY mark_j_smith@fpl.com BRUCE MCLAUGHLIN BRAUN & BLAISING, P.C. mclaughlin@braunlegal.com MARC D. JOSEPH ADAMS, BROADWELL, JOSEPH & CARDOZO mdjoseph@adamsbroadwell.com MARY LYNCH CONSTELLATION ENERGY COMMODITIES GROUP mary.lynch@constellation.com MICHEL PETER ELORIO MARK FRAZEE MICHAEL J. GERGEN MIKE JASKE CALIFORNIA ENERGY COMMISSION THE UTILITY REFORM NETWORK (TURN)
mflorio@turn.org CITY OF ANAHEIM mfrazee@anaheim.net LATHAM & WATKINS LLP MICHAEL MAZUR 3 PHASES ELECTRICAL CONSULTING MARGARET E. MCNAUL THOMPSON COBURN LLP MONA TIERNEY CONSTELLATION NEW ENERGY, INC. CORAL POWER, L.L.C. mmazur@3phases.com mmcnaul@thompsoncoburn.com mmilner@coral-energy.com mona.tierney@constellation.com MANUEL RAMIREZ CITY AND COUNTY OF SAN FRANCISCO mramirez@sfwater.org MICHAEL SHAMES
UTILITY CONSUMERS' ACTION NETWORK
mshames@ucan.org MIKE RINGER MRW & ASSOCIATIES, INC. mrw@mrwassoc.com CALIFORNIA ENERGY COMMISSION mringer@energy.state.ca.us Merideth Sterkel CALIF PUBLIC UTILITIES COMMISSION mts@cpuc.ca.gov MARY O. SIMMONS Mark S. Wetzell CALIF PUBLIC UTILITIES COMMISSION MICHAEL TEN EYCK CITY OF RANCHO CUCAMONGA MTENEYCK@CI.RANCHO-CUCAMONGA.CA.US SIERRA PACIFIC POWER COMPANY msimmons@sierrapacific.com NANCY TRONAAS CALIFORNIA ENERGY COMMISSION PATRICIA GIDEON PACIFIC GAS AND ELECTRIC COMPANY PHILIP HERRINGTON EDISON MISSION ENERGY Nancy Ryan CALIF PUBLIC UTILITIES COMMISSION ner@cpuc.ca.gov ntronaas@energy.state.ca.us pca8@pae.com pherrinaton@edisonmission.com PHILLIP J. MULLER SCD ENERGY SOLUTIONS philm@scdenergy.com PHILIP D. PETTINGILL CALIFORNIA INDEPENDENT SYSTEM OPERATOR ppettingill@caiso.com NICOLAS PROCOS ALAMEDA POWER & TELECOM procos@alamedapt.com PHILIPPE AUCLAIR phil@ethree.com RICK C. NOGER PRAXAIR PLAINFIELD, INC. RONALD MOORE SOUTHERN CALIFORNIA WATER CO. Robert L. Strauss CALIF PUBLIC UTILITIES COMMISSION Rahmon Momoh CALIF PUBLIC UTILITIES COMMISSION rick_noger@praxair.com ROD AOKI ALCANTAR & KAHL, LLP rsa@a-klaw.com REED V. SCHMIDT BARTLE WELLS ASSOCIATES ROBERT SHERICK PASADENA WATER AND POWER rsherick@cityofpasadena.net ROGER VANHOY MSR PUBLIC POWER AGENCY

Robert J. Wullenjohn CALIF PUBLIC UTILITIES COMMISSION rw1@cpuc.ca.gov ROBERT'S NICHOLS SAEED FARROKHPAY ROBIN J. WALTHER, PH.D. FEDERAL ENERGY REGULATORY COMMISSION saeed.farrokhpay@ferc.gov NEW WEST ENERGY rsnichol@srpnet.com LINDA Y. SHERIF CALPINE CORPORATION sherifl@calpine.com C. SUSIE BERLIN MC CARTHY & BERLIN, LLP SCOTT TOMASHEFSKY NORTHERN CALIFORNIA POWER AGENCY SEAN CASEY SAN FRANCISCO PUBLIC UTILITIES COMMISSIO scasey@sfwater.org sberlin@mccarthvlaw.con scott.tomashefskv@ncpa.com

roaerv@mid.ora

STEVE ISSER GOOD COMPANY ASSOCIATES sisser@goodcompanyassociates.com SEEMA SRINIVASAN ALCANTAR & KAHL, LLP sls@a-klaw.com SEBASTIEN CSAPO PACIFIC GAS AND ELECTRIC COMPANY sscb@pge.com Sudheer Gokhale CALIF PUBLIC UTILITIES COMMISSION skg@cpuc.ca.gov

STEVEN S. SCHLEIMER CALPINE CORPORATION sschleimer@calpine.com

STEVEN M. J. ARON & COMPANY steven.bunkin@gs.com

THOMAS CORR SEMPRA ENERGY tcorr@sempraglobal.com

THEODORE ROBERTS SEMPRA ENERGY troberts@sempra.com

WILLIAM W. WESTERFIELD III STOEL RIVES LLP www.esterfield@stoel.com

ROBERT MARSHALL PLUMAS-SIERRA RURAL ELECTRIC CO-OP PO BOX 2000 PORTOLA, CA 96122-2000

STEPHEN J. SCIORTINO CITY OF ANAHEIM ssciortino@anaheim.net

STEVEN KELLY INDEPENDENT ENERGY PRODUCERS ASSN steven@iepa.com

THOMAS DARTON PILOT POWER GROUP, INC. tdarton@pilotpowergroup.com

VALERIE WINN PACIFIC GAS & ELECTRIC vjw3@pge.com

RANDALL PRESCOTT BP ENERGY COMPANY 501 WESTLAKE PARK BLVD. HOUSTON, TX 77079

AKBAR JAZAYEIRI SOUTHERN CALIFORNIA EDISON COMPANY 2244 WALNUT GROVE AVE. ROOM 390 ROSEMEAD, CA 91770

STACY AGUAYO APS ENERGY SERVICES stacy.aguayo@apses.com

SOUMYA SASTRY PACIFIC GAS AND ELECTRIC COMPANY svs6@pge.com

TONY ZIMMER Tony.Zimmer@ncpa.com

WILLIAM H. BOOTH LAW OFFICES OF WILLIAM H. BOOTH wbooth@booth-law.com

MIKE KASABA QUIET ENERGY 3311 VAN ALLEN PLACE TOPANGA, CA 90290

MEGAN SAUNDERS SEMPRA ENERGY SOLUTIONS 101 ASH STREET, HQ09 SAN DIEGO, CA 92101-3017

STEVE KOERNER EL PASO CORPORATION

Traci Bone CALIF PUBLIC UTILITIES COMMISSION tbo@cpuc.ca.gov

TRACEY DRABANT BEAR VALLEY ELECTRIC SERVICE traceydrabant@bves.com

WAYNE TOMLINSON EL PASO CORPORATION william.tomlinson@elpaso.com

DAVID J. COYLE ANZA ELECTRIC COOPERATIVE, INC PO BOX 391090 ANZA, CA 92539-1909