California Independent System Operator Corporation

August 27, 2007

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

**Re: California Independent System Operator Corporation, Docket Nos. ER07-869-000; ER07-475-000; and ER06-615-001 (Amendments in Compliance with the Commission's July 6, 2007 Order)**

Dear Secretary Bose:

Enclosed for filing in the above-referenced docket is the California Independent System Operator Corporation's Motion for Leave to File Answer and Answer in the above-referenced proceedings.

Thank you for your assistance in this matter.

Respectfully submitted,

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

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| **California Independent System Operator Corporation** | **)** **)** | **Docket Nos. ER07-869-000** **ER07-475-000** **ER07-475-001** **ER06-615-001** |

# MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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# MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

## I. INTRODUCTION

On July 20, 2007, the California Independent System Operator Corporation ("CAISO") submitted proposed tariff amendments in compliance with Federal Energy Regulatory Commission ("FERC" or "Commission") orders issued on September 21, 2006,[1] April 20, 2007,[2] June 25, 2007,[3] and July 6, 2007[4] in the above-captioned dockets ("July 20 Compliance Filing"). The tariff provisions involve the initial Congestion Revenue Right ("CRR") allocation and auction processes under the Market Redesign and Technology Upgrade ("MRTU") Tariff and relate to: (i) the transfer of CRRs due to Load Migration and the CAISO's tracking of these transfers, (ii) the modeling of transmission outages in the network model used for CRR purposes, (iii) the use of common load forecasts for monthly CRR eligibility and monthly resource adequacy showings, and (iv) nine requirements contained in the Commission's *July 6 Order*.

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1 *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 (2006) ("September 2006 Order").

2 *California Independent System Operator Corporation, Order on Reh'g,* 119 FERC ¶ 61,076 ("April 20 Rehearing Order").

3 *California Independent System Operator Corporation, Order on Compliance*, 119 FERC ¶ 61,313 ("June 25 Compliance Order") in Docket Nos. ER06-615-000 to 003 and ER06-615-005.

4 *California Independent System Operator Corporation*, 120 FERC ¶ 61,023 (2007) ("July 6 Order") in Docket Nos. ER07-869-000; ER07-475-000; and ER06-615-001.

Comments, Protests and Motions to Intervene were filed on August 10, 2007.[5]

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2005), the CAISO hereby requests leave to file this answer to the comments, protests and motions to intervene submitted in the above-referenced proceeding. The CAISO also requests leave to answer the Request for Rehearing of San Diego Gas & Electric Company ("SDG&E") regarding the CAISO's treatment of so-called seller's choice contracts for the purposes of implementing CRR source verification.[6] The CAISO requests waiver of Rule 213(a)(2) (18 C.F.R. § 385.213(a)(2)) to permit it to make an answer to the protests and to the SDG&E request for rehearing.

In applying Rule 213(a)(2), the Commission has accepted answers that are otherwise prohibited by this rule if such answers clarify the issues in dispute[7] or assist the Commission's resolution of the matter.[8] Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case at a time when timely resolution of these issues is critical.[9] To that end, the CAISO's answer only addresses issues that serve to correct misconceptions raised in

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5 The following seven entities filed comments and protests: Alliance for Retail Energy Markets ("AReM"); California Department of Water Resources State Water Project ("SWP"); California Public Utilities Commission ("CPUC"); Imperial Irrigation District ("IID"); Pacific Gas & Electric ("PGE"); Sacramento Municipal Utility District ("SMUD"); and Southern California Edison ("SCE").

6 *See* discussion in Section II.D., *infra*.

7 *Southwest Power Pool, Inc*. 89 FERC ¶ 61,284 at 61,888 (2000); *Eagan Hub Partners, L.P.,* 73 FERC ¶ 61,334 at 61,929 (1995).

8 *El Paso Electric Company*, 72 FERC ¶ 61,292 at 62,256 (1995).

9 *See, e.g.*, *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Co.*, 93 FERC ¶ 61,098, at 61,259 (2000).

comments, protests, and SDG&E's request for rehearing or otherwise help clarify the record.[10]

## II. ANSWER

### A. Load Migration Issues

#### 1. It Is Appropriate to Allow a Load-Gaining LSE to have Access to the Priority Nomination Process for CRRs Acquired Due to Load Migration

Proposed Section 36.8.5.3 allows a Load-gaining LSE that has received a new Seasonal CRR due to Load Migration to nominate that CRR in the Priority Nomination Process ("PNP") in the next annual CRR process. PG&E, SCE, and the CPUC object to this aspect of the CRR Load Migration tariff provisions. PG&E at 1-3, SCE at 2-7, and CPUC at 9-12. Each of these entities prefers the tariff provision that was filed in February of 2006 and retained in the January 29, 2007 and the May 7, 2007 CRR filings.[11] The previous tariff provision provided that there would be no increase in an LSE's PNP Eligible Quantities due to an increase in Load due to Load Migration; rather, a Load-gaining LSE was allowed to acquire additional CRRs for net Load gained in Tiers 2 and 3 of the subsequent annual CRR Allocation.[12] In order to ensure a Load-gaining LSE would have the opportunity to acquire the additional CRRs due to Load Migration, the CAISO previously proposed that it would reserve in the PNP the CRRs released by LSEs whose PNP Eligible Quantities were reduced and then release the reserved CRRs for

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[10] The fact that the CAISO has not addressed every issue in the protests and comments should not be deemed to be agreement or acquiescence by the CAISO on the issues not addressed.

[11] The January 29, 2007 filing in Docket No. ER07-475 ("January 29 Filing") was made in compliance with the Commission's Final Rule in Docket No. RM06-8-000. *See Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 71 Fed. Reg. 43564 (Aug. 1, 2006), FERC Stats. & Regs. ¶ 31,226 (2006) ("Order No. 681"); and Order No. 681-A, 117 FERC ¶ 61,201 (2006) ("Order No. 681-A"). The May 7, 2007 filing in Docket Nos. ER07-869-000 and ER06-615-001 ("May 7 Filing") was in part a new Federal Power Act ("FPA") Section 205 filing to implement the initial CRR allocation and auction processes under MRTU and in part in compliance with the *September 2006 Order* and the *April 20 Rehearing Order*.

[12] *See* Section 36.8.5.1 as filed in the February 9, 2006 MRTU Filing and as retained in the *January 29 Filing* and *May 7 Filing*.

Tiers 2 and 3.[13]

SCE believes the previous tariff provisions appropriately balanced competing objectives. SCE at 6-7. PG&E believes that the approach contained in the previous tariff language (*i.e.*, having both parties nominate in Tier 2) is more appropriate and that allowing a Load-gaining LSE to nominate the acquired CRRs in the PNP is ill-advised and inappropriately disadvantages the Load-losing LSE relative to the Load-gaining LSE. PG&E at 2. The CPUC believes the CAISO's proposed "replacement methodology" facilitates unfair outcomes in the short term and long term CRR allocation processes. CPUC at 11. All of these objections are premised on the following points: (i) that by giving a Load-gaining LSE a share of the Load-losing LSE's CRRs (in proportion to the lost Load), the Load-losing LSE is losing CRRs sourced at a resource that it will still use to serve its Load, (ii) a Load-gaining LSE will use a different set of resources to serve the Load that migrated and does not need a CRR sourced from the resources of the Load-losing LSE, and (iii) giving the Load-gaining LSE the ability to nominate the acquired CRR in the next annual PNP unfairly disadvantages a Load-losing LSE in its attempt to acquire (or re-acquire) CRRs sourced from its own resources.

The CAISO does not dispute the first two of the three points stated above, but does disagree with the third point. Specifically, the CAISO is concerned that the proposals advocated by SCE, PG&E and the CPUC will unfairly disadvantage end-use customers that migrate between LSEs by creating additional risk (compared to the CAISO's filed proposal) that the Load-gaining LSE will not be able to receive the appropriate share of the value of the portfolio of CRRs that were allocated to the Load-losing LSE.

The CAISO acknowledges that it is reasonable to assume that: (i) a Load-losing LSE will

[13] *Id*.

still use its same supply resources to serve its remaining Load; that is, a Load-losing LSE generally will not transfer *pro rata* portions of its supply portfolio to the Load-gaining LSE when Load migrates, and the Load-losing LSE may therefore want to replace the CRRs it lost due to the required CRR transfer; and (ii) a Load-gaining LSE will typically not be using the exact same set of supply resources that the load-losing LSE uses to serve its Load. However, these considerations do not lead to a conclusion that the CAISO's proposal to allow only the Load-gaining LSE to nominate the transferred CRRs in the next year's PNP creates an unfair disadvantage for the Load-losing LSE.

As a preface to the last assertion, it is important to recognize that the CAISO's entire approach to the Load Migration CRR transfer is based on the principle that what should be transferred is a proportionate or *pro rata* portion of the *financial value* – not the MW quantity – of the allocated CRRs from a Load-losing LSE to a Load-gaining LSE. The Commission has already accepted the CAISO's approach to transferring CRRs to reflect Load Migration on the basis of the overall *value* of the Load-losing LSE's allocated CRRs.[14] The Commission has also rejected proposals to allow a Load-losing LSE to exempt specific CRRs from the required transfer as inconsistent with a valued-based approach. The Commission also has noted that it is uncertain whether any of a Load-losing LSE's CRRs will be sourced at locations that correspond to the supply resources a Load-gaining LSE.[15] The importance of such correspondence is secondary, however, to the proper transfer of value because CRRs are a purely financial instrument that provide a revenue stream to the holding LSE to enable the LSE to manage the congestion costs associated with the CAISO's Locational Marginal Pricing ("LMP") based new

[14] *July 6 Order* at P 211.

[15] *Id*.

market structure. The Commission has accepted the fundamental principle that allocated CRRs fundamentally belong to Load[16]; and on this basis the CAISO determines each LSE's eligibility for CRR allocation in proportion to the quantity of Load served by the LSE[17] that is exposed to congestion charges through use of the CAISO Controlled Grid. The consistency of the CAISO's proposal on Load Migration CRR transfers was fully articulated in the CAISO's May 18, 2007 CRR Issues Paper;[18] the June 7, 2007 Straw Proposal,[19] and the June 25, 2007 Final Proposal.[20] Although PG&E, SCE and CPUC all are correct that allowing a Load-gaining LSE to nominate the acquired CRRs in the PNP is a change from the previous tariff provisions, the change is a direct result of the stakeholder process on CRRs and Load Migration. In particular this change is based on the recognition that the renewability of allocated CRRs is a key element of their value to the LSE, and by consequence, their value to the Load represented by the LSE. This is especially so in a CRR market structure that includes both Long Term CRRs and short-term CRRs (*i.e.*, one-year Seasonal CRRs), and which the CAISO carefully designed through the Long-Term CRR stakeholder process to avoid creating inessential distinctions between Long Term and short-term CRRs that might create inefficient incentives for LSEs to prefer one or the other. The CAISO's proposal on renewability of Load Migration CRRs in the PNP by a Load-gaining LSE thus is consistent with this design objective for long-term rights that was identified in the Commission's final rule[21] and incorporated in the CAISO's Long Term CRR filing.[22]

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16 *See September 2006 Order* at P 789.

17 *See* Section 36.8.2 of the MRTU Tariff.

18 The May 18, 2007 CRR Issues Paper can be found at: www.caiso.com/1be2/1be2dd2449840.pdf.

19 The June 7, 2007 Straw Proposal can be found at: www.caiso.com/1bf7/1bf76e4e35b80.pdf.

20 The June 25, 2007 Final Proposal can be found at: www.caiso.com/1c08/1c08139603fc70.pdf.

21 *See generally Order 681* at PP 255-272 ( Commission conclusions on Guideline 4); *see also Order 681* at P 266 (indicating that there should be little change in the renewal process when long-term rights are offered as long as the transmission system is being planned and upgraded to accommodate the rights).

Contrary to the comments of PG&E and SCE, allowing a Load-gaining LSE – and not the Load-losing LSE – to nominate the transferred CRRs in the PNP is necessary to ensure that a Load-gaining LSE will receive the value of the new CRRs allocated due to Load Migration. The CAISO acknowledges that its original proposal as filed in February 2006 would also have addressed this requirement, but for reasons explained below the CAISO has since identified a concern with that proposal that requires revising it. If in revising the February 2006 proposal, the revised rules were to allow both the Load-gaining and Load-losing LSE to nominate the transferred CRRs in the PNP, or if the revised rules were to allow neither LSE to nominate the transferred CRRs in the PNP, the Load-gaining LSE might not be able to obtain the full amount of CRRs associated with the migrated Load for the year following the Load migration. This consideration or rationale was set forth in the CAISO June 25, 2007 Final Proposal on CRRs. In that paper the CAISO explained the reasons for this change to the tariff provisions as well as describing the new method for executing the transfer of CRRs for Load migration (*i.e.*, that it will create and allocate equal and opposite sets of new CRRs for each pair of LSEs affected by Load Migration). The CAISO statements are worth quoting in full, after which the CAISO provides a simple example that illustrates the concerns; the CAISO indicated that:

> [the new] approach provides for *the appropriate CRR revenue stream* to be transferred without [a Load-losing LSE] having to give up any of its allocated CRRs. . . .In order to fully reflect the value of the transferred CRRs, the CAISO anticipates that it will allow the load-gaining LSE to nominate the transferred CRRs in the Priority Nomination Tier (PNT, Tier 1) of the next annual CRR Allocation process. . . . This change from the CAISO's original CRR proposal reflects the CAISO's subsequent work on validation of its CRR design during MRTU implementation. *Originally,* the CAISO had planned to insert CRRs in the PNT (and only in the PNT) that would be equivalent to the transferred CRRs,

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[22] *See* Transmittal Letter to *January 29 Filing* at 20-21 (compliance with Guideline 4); *see also* Transmittal Letter to *January 29 Filing* at 13-15 (discussing release of Long Term CRRs in CRR Year Two and subsequent years).

> so that the capacity would be reserved for the load-losing or load-gaining LSE to receive in Tier 2 or 3. The CAISO has subsequently become concerned that if it were to insert these CRRs in Tier 1 and neither LSE subsequently requested them, other CRRs awarded in Tier 1 could be infeasible in Tiers 2 and 3. *If the CAISO were to use an alternative approach of not allowing either the load-losing or load-gaining LSE to request the transferred CRR in the PNT, there would be a risk that other CRRs that are allocated in the PNT would make the transferred CRR infeasible after the PNT. Moreover, the load-gaining LSE would have to compete with other LSEs to obtain any transferred CRRs that remain feasible at the time of Tier 2 and might not be able to obtain the full amount of the transferred CRR, even with the explicit increase in its nomination limit to account for the gain in load.* Fundamentally, the CRR belongs to the load that transferred between LSEs, and the surest way to ensure that the CRR remains available for serving the load is by allowing it to be requested by the LSE that now serves the load. *If the load-gaining LSE were not allowed to nominate the transferred CRRs in the PNT, the loss in value to the load would need to be offset in some other way, such as an increase in the load-gaining LSE's eligibility in the PNT*. The load-losing LSE is not without options if it wants to regain the CRR, since it can arrange a bilateral sale of the new CRRs with the load-gaining LSE.

June 25, 2007 Final Proposal on CRRs at p. 10 (emphases added).

In its comments on the *July 20 Compliance Filing*, SCE quoted part of the CAISO's explanation set forth above and concluded that the CAISO does not need to insert CRRs in the Priority Nomination Tier ("PNT").[23] However, SCE's argument conveniently ignores the fact that even if the CAISO did not allow either the Load-losing or Load-gaining LSE to nominate the transferred CRRs in the PNT, the CAISO still had concerns that: (i) the transferred CRR would be infeasible after the PNT and (ii) a Load-gaining LSE "would have to compete with other LSEs to obtain any transferred CRRs that remain feasible at the time of Tier 2 and might not be able to obtain the full amount of the transferred CRR, even with the explicit increase in its nomination limit to account for the gain in load."[24]

The comments of PG&E and the CPUC are similar to SCE. PG&E states that "[h]aving

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[23] SCE at 5-6.

[24] June 25, 2007 Final Proposal at 10.

both parties nominate in Tier 2 is more appropriate."[25] The CPUC says that "both the load losing LSE and the load gaining LSE should have equal priority to re-nominate the CRRs in question."[26] The CPUC believes that the risk of infeasibility in Tier 2 is "minimal" and "unlikely"; however, the CPUC does not address the fact that even if the transferred CRRs remain feasible in Tier 2 the Load-gaining LSE will compete with all other LSEs to obtain the transferred CRR.[27] In short, SCE, PG&E, and the CPUC all ignore the fact that a Load-gaining LSE will have a decreased chance of obtaining the value of the transferred CRRs in Tier 2 as compared to being able to nominate the CRRs in the PNT.

The following example illustrates the potential for a Load-gaining LSE to receive less than its appropriate share of the Load-losing LSE's allocated CRRs under the "equal priority" approach advocated by PG&E and the CPUC. Suppose LSE-1 was allocated a 50 MW CRR from source A to its load at sink B, and then loses 20 percent of its load to LSE-2. The CAISO's proposed CRR transfer approach would allocate a 10 MW CRR from A to B to LSE-2 and would assign a 10 MW "offsetting" CRR from B to A to LSE-1. The PG&E and CPUC proposal would allow neither LSE to nominate in the PNP the A-to-B CRRs associated with the transfer, and would allow both LSEs to nominate them in Tier 2. Thus LSE-1 would nominate and renew a 40 MW CRR from A to B in the PNP, and then nominate a 10 MW CRR from A to B in Tier 2, while LSE-2 would only be able to nominate a 10 MW CRR from A to B in Tier 2. Now suppose that a constraint between A and B is binding such that 50 MW is the maximum amount

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[25] PG&E at 2. Like SCE, PG&E argues that it is the LSE who lost load, not the LSE who gained load, that faces the challenge to manage congestion associated with the resource held by the LSE who lost load. *Id*.

[26] CPUC at 9.

[27] CPUC at 11.

of CRRs that can be allocated from A to B absent the creation of additional CRRs from B to A.[28] As a result each LSE would be allocated a 5 MW CRR from A to B in Tier 2, which is a pro rata share of the available 10 MW proportional to the amount of each LSE's nomination. Thus LSE-1 gets a total of 45 MW of CRRs from A to B and LSE-2 gets only 5 MW.

A variation of this "equal priority" approach might be to allow both LSEs to nominate the CRRs in question in the PNP. Under that approach, LSE-1 would nominate 50 MW and LSE-2 would nominate 10 MW, and the pro rata adjustment would award 41.7 MW to LSE-1 and 8.3 MW to LSE-2. In contrast, under the CAISO's proposal to allow only the Load-gaining LSE to utilize the PNP for this particular CRR, LSE-1 would get 40 MW and LSE-2 would get 10 MW.

The point of this example is that when CRR availability is limited by binding transmission constraints, in the absence of an explicit mechanism to provide priority access to CRRs by LSEs that gain net Load through Load Migration, customers that choose to migrate to the retail service of another LSE risk losing some of the CRR coverage they had prior to migrating. The CAISO's original proposal as filed in February 2006 addressed this problem through the combination of (i) the insertion into the PNP of placeholder CRRs corresponding to the CRRs transferred due to Load migration, followed by the removal of the placeholder CRRs prior to the running of Tier 2, and (ii) an increase in each net-Load-gaining LSE's Tier 2 eligible quantity. Subsequent to that filing, however, the CAISO recognized that part (i) of the filed proposal could have adverse unintended consequences by rendering some of the CRRs awarded in the PNP infeasible going into Tier 2. Thus, there is no question that the originally filed

[28] It is important to note that the 10 MW offsetting CRR from B to A that was assigned to LSE-1 cannot be renewed in the PNP, and that for allocation purposes LSEs can only nominate CRRs that sink at their load location, so there is no possibility in this process to nominate additional CRRs from B to A that would allow the 50 MW constraint to be exceeded.

proposal must be revised. After careful consideration and through the stakeholder process, the CAISO concluded that its latest proposal best preserves the principle that CRRs are allocated for the benefit of end-use customers, and the consequent market design principle that when those customers migrate between LSEs their migration should be accompanied by a proportional transfer of the value of the Load-losing LSE's allocated CRRs.

The CPUC offers a second suggestion as to how the CAISO's concerns could be addressed.[29] The CPUC states that the CAISO could, prior to the PNP, solicit confidential commitments from the Load-losing and Load-gaining LSEs as to whether they would nominate the CRRs transferred due to load migration.[30] If either LSE (or both) committed to nominating the CRRs in question, then the CAISO could insert the dummy request into the PNP, thereby ensuring that the CRRs would be available in the next tier.[31] While the CAISO appreciates the CPUC suggestion, it is essentially equivalent to allowing both LSEs to nominate the CRRs in question in the PNP, though the outcome could be slightly different. First note that the PNP (Tier 1) outcome would be the same regardless of whether the two LSEs put in the nominations or the CAISO puts in the nominations on their behalf. If the "confidential commitments" of the LSEs are truly binding commitments and the CAISO puts in the PNP nominations, the LSEs would then submit Tier 2 nominations that exactly match the CAISO PNP nominations that cleared the PNP. Under the two-step process there would be some risk that the removal of the CAISO-nominated CRRs would create some infeasibility of the other PNP-awarded CRRs at the start of Tier 2, which could cause the Tier 2 results for the Load Migration CRRs to differ from the PNP results, but any such difference should be small due to the fact that the LSE Tier 2

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29 CPUC at 11-12.

30 *Id*.

31 *Id*.

nominations are using the same grid capacity that was utilized by the cleared CAISO PNP nominations. Thus, the CPUC proposal adds some risk and administrative complexity to the approach of allowing both LSEs to nominate the Load Migration CRRs in the PNP, but would probably yield roughly the same result. As such the CPUC proposal suffers from the same problem illustrated in the example above, *i.e.*, in the presence of binding constraints it creates some risk that the migrating end-use customers will not receive their full share of the value of the Load Migration CRRs.

In sum, the CAISO respectfully requests that the Commission reject the comments of SCE, PG&E and the CPUC and approve the tariff provisions that allow a Load-gaining LSE that has received a new Seasonal CRR due to Load Migration to nominate the CRR in the PNP in the next annual CRR process.

### 2. The Transmission Planning Process Will Assure That Long Term CRRs Remain Feasible Over Their Term and Will Assure That There is Sufficient Transmission Capacity To Accommodate New Generating Resources

The CPUC asserts that the compliance filing threatens to impede, and fails to provide a methodology to assure, the availability of CRRs for generation to be added to the grid in the future.[32] The CPUC believes that the future availability of CRRs for new resources is inherently intertwined with the ongoing feasibility of Long Term CRRs that the CAISO allocates.[33]

There are at least two different aspects to the CPUC's comments to which the CAISO is providing a response. First, the CPUC states that "to some extent, the allocation of CRRs for future resources may impact feasibility of [Long Term] CRRs already issued" and second, that "[i]nversely, one way that CAISO may assure long-term feasibility of [Long Term] CRRs

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[32] CPUC at 18-22.

[33] CPUC at 18.

already issued is to prevent new generation from adding congestion to the grid, essentially by withholding grid capacity from the new resource."[34] The CPUC concerns are addressed by the CAISO's overall transmission rights policy as follows.

With regards to both concerns, the CAISO already has a duty under the Commission's Final Rule on long-term firm transmission rights, reflected in the MRTU Tariff conditionally-accepted by the Commission in its *July 6 Order*, to maintain the feasibility of Long Term CRRs over the course of their term.[35] As part of its compliance requirements to Order No. 890, the CAISO is working with its stakeholders to supplement its tariff and any supporting documentation as necessary to describe more precisely how its transmission practices and procedures will ensure that no such erosion will occur. As part of its overall grid planning process, this obligation requires that the CAISO ensure that new transmission or generation does not add transmission congestion to the grid or otherwise degrade the transfer capability of grid facilities such that the feasibility of outstanding Long-Term CRRs is compromised. No additional measures are necessary and in fact could possibly lead to redundancy of its procedures that would require further policy development to carefully tailor any such measures.

Moreover, the Commission accepted the CPUC's proposal to limit an LSE's eligibility for Long Term CRRs to twenty percent (20%) of its Adjusted Load Metric ("ALM").[36] The Commission stated that the "gradual approach to the release of CRR[s] not only provides

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34 *Id*.

35 *See* MRTU Tariff § 24.1.3; *see also Order 681* at P 170 (explaining that "firmness" refers to two properties of the long-term transmission rights: stability in the quantity of rights that a load serving entity is allocated over time and "price certainty" for the load serving entity that seeks to hedge congestion charges associated with a particular generation resource or transmission path). Once allocated, Long Term CRRs will be modeled as fixed injections and withdrawals on the DC FNM used in subsequent allocation and auction processes, *see* MRTU Tariff § 36.4.1; there will be no degradation in the feasibility of allocated Long Term CRRs due to future CRR allocation and auction processes. As noted above, the CAISO also will ensure the continued feasibility or stability in the amount of an allocated Long Term CRR through the transmission planning process. *See* MRTU Tariff § 24.1.3.

36 *July 6 Order* at P 136.

certainty to entities that have already made long-term procurement decisions but also *provides flexibility to LSEs nominating CRRs in future years to match future procurement decisions*."[37] Notwithstanding the Commission actions, the CPUC asserts that "[a]bsent a requirement that the CAISO design and implement a methodology to assure that CRRs will be available to hedge congestion for new grid elements, the FERC's ordered modifications will ultimately fail to provide the intended benefit."[38]

The CAISO understands the CPUC's concerns but respectfully suggests that there is no indication that Long Term CRRs will be unavailable in the future for LSEs that either build or contract with new generation resources. An LSE's eligibility for allocated CRRs is determined by the LSE's ALM. Under the adopted CAISO CRR rules, if a developer of new generation contracts to sell the output of the generation to an LSE, the LSE will have the ability to obtain Long Term CRRs to hedge the congestion risk of serving its Load. If the interconnection of new generation requires an upgrade to the transmission system, the CAISO's interconnection procedures (including the Commission's approval of an appropriate variation from Order No. 2003's default generator interconnection policies for remote resources[39]) will ensure that the transmission system will be expanded to accommodate the new generation and the new transmission capacity will increase the quantity of CRRs that are available under the MRTU Tariff. The CPUC has not demonstrated that a new methodology to assure that CRRs will be available is required. Moreover, as noted elsewhere in the instant filing, the implementation of exceptions to the twenty percent of ALM limitation on Long Term CRR eligibility should also

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37 *Id*. at P 137 (emphasis added).

38 CPUC at 20-21.

39 *See California Independent System Operator Corporation*, 119 FERC ¶ 61,061, *Order Granting Petition* (April 19, 2007).

help to alleviate the CPUC's concern.

Finally, due to its concern over the availability of Long Term CRRs for new generation, the CPUC asks that FERC clarify the *July 6 Order* to specifically "defer to the mutually agreeable proposal offered by the CAISO in its June 14 comments, which may also alleviate potential inequities foreseen by San Diego Gas and Electric [Company] ("SDG&E") and to California ratepayers." CPUC at 22. The CPUC is referring to the CAISO's answer to comments on the May 7 Filing in Docket No. ER07-869-000 and the CAISO's opinion on the second of two alternatives put forth by SDG&E. SDG&E's proposal would make the resource-based priorities for tiers 1 and 2 in MRTU Year One limited to the term of the underlying commercial arrangement. While the CAISO did not adopt or offer the SDG&E proposal as a CAISO proposal, it did state that if the proposal were adopted it: (i) would not impact the rules currently being implemented in preparation of the first annual CRR allocation, and (ii) would have a minimal impact (if any) on the implementation schedule.[40] Specifically, the CAISO noted that SDG&E's proposal could be implemented by limiting the renewability in the PNP of CRRs associated with contracts that were valid in 2006 but, for example expire prior to 2009.[41] Such contracts would not be renewable in the PNP for 2009 and in subsequent years but could be nominated in the free choice tiers.[42] The CAISO has not changed its opinion of the SDG&E proposal endorsed by the CPUC. The CAISO did not propose any changes to its previously adopted rules and has already provided substantial evidence in support of the justness and reasonableness of its adopted rules. At this time, the CAISO simply reiterates that it continues to believe that its filed proposal regarding the historic reference period is a reasonable balance of

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40 *See* CAISO June 14, 2007 Answer at p 24.

41 *Id*. at 25.

42 *Id*.

competing concerns; nonetheless, SDG&E's concerns could be addressed in part by incorporating a sunset date on PNP renewability of CRRs associated with contracts submitted for CRR Year One source verification.

In sum, the CAISO does not agree with the CPUC that a new methodology needs to be developed to assure that Long Term CRRs will be available in the future for new generating resources. However, as noted above, some of the CPUC's concerns could be addressed in part by incorporating a sunset date on PNP renewability of CRRs associated with contracts submitted for CRR Year One source verification.

### 3. The CAISO Clarifies the Tariff Provisions Limiting an LSE's or OCALSE's Eligibility to Nominate Long Term CRRs to Twenty Percent of the Entity's Adjusted Load Metric

In the *July 6 Order* the Commission found that there is a strong incentive for parties to lock-up a significant portion of grid capacity as Long Term CRRs in CRR Year One which would reduce flexibility for LSEs in later years. Consequently, the Commission accepted a proposal to limit an LSE's or OCALSE's Long Term CRR eligibility to twenty percent (20%) of its ALM in CRR Year One.[43] In the subsequent three years, the capacity eligible for Long Term CRRs will increase in increments of ten percent (10%) of the ALM each year until all LSEs and OCALSEs are eligible for Long Term CRRs up to fifty percent (50%) of their ALM.[44]

The CPUC states that additional detail is required to implement the FERC ordered limit on availability of Long-Term CRRs.[45] SCE and PG&E state that the tariff language implementing the restriction on eligibility for Long Term CRRs is correct but claim that

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43 *July 6 Order* at P 136.

44 *Id*.

45 *See* CPUC at 2-9.

statements in the CAISO's transmittal letter are either unclear or inconsistent with the tariff language.[46] SCE requests clarification, PG&E asks that the Commission make clear that the tariff provisions govern.[47]

The CAISO agrees to clarify the tariff language as described below. The existing, proposed tariff language reads in relevant part as follows:

> The quantity of Seasonal CRRs that an LSE can nominate as Long Term CRRs is limited to twenty percent (20%) of the LSE's Adjusted Load Metric, except that an LSE that can demonstrate that more than twenty percent (20%) of its Adjusted Load Metric is covered by a combination of long-term procurement arrangements of ten (10) years or greater and ownership of generation resources is able to submit nominations for a greater amount as provided in this section.
> * * * *
> If the LSE has demonstrated that more than twenty percent (20%) of its Adjusted Load Metric is covered by a combination of long-term procurement arrangements of ten (10) years or greater and ownership of generation resources, *the amount of Long Term CRRs that it may nominate is equal to the minimum of: (i) the sum of the owned resources and long-term procurement arrangements of ten (10) years or more and (ii) fifty percent (50%) of the LSE's Adjusted Load Metric*.

Proposed MRTU Tariff § 36.8.3.1.3.1 (emphasis added). The CPUC had four possible interpretations of the above-quote language, only two of which it found acceptable.[48]

- The CPUC's first possible interpretation is that an LSE is eligible to nominate Long Term CRRs equal to the amount of LSE's long term procurement arrangements or owned generation.[49]

- The CPUC's second possible interpretation is that an LSE is eligible to nominate Long Term CRRs equal to 20% of its ALM plus the amount of LSE's long term procurement arrangements or owned generation (the CPUC uses the term "long term sources" to describe the combination of an LSE's long term procurement arrangements and owned generation).[50]

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46 *See* SCE at 10-12; PG&E at 4.

47 *Id*.

48 CPUC at 2-9.

49 CPUC at 4-5.

50 CPUC at 5-6.

- The CPUC's third possible interpretation is that an LSE is eligible to nominate Long Term CRRs equal to the 20% ALM limit but that beyond that limit any Long Term CRR nomination must be associated with long term sources (*i.e.*, long term procurement arrangements or owned generation).[51]

- The fourth possible interpretation is that an LSE is eligible to nominate Long Term CRRs equal to their total demonstrated quantity of long term procurement arrangements or owned generation but that if the quantity exceeds 20%, then all of the Long Term CRR nominations must be associated with long term sources (*i.e.*, long term procurement arrangements or owned generation).[52]

The CPUC states that the 3rd and 4th interpretations are acceptable. The CPUC considers the third interpretation to be in accordance with both the letter and spirit of the CPUC proposal, the CAISO's comments, and the *July 6 Order*.[53] The CPUC also believes the 4th interpretation to be accordance with the letter and spirit of previous CPUC comments, CAISO filings, and the *July 6 Order*. The CPUC explains that under the 4th interpretation, an LSE would have a choice between: (i) nominating any eligible CRR for conversion to a Long Term CRRs, capped at 20% of its ALM, or (ii) nominating only CRRs sourced at long term sources, with ability to nominate as many as the LSE desires, so long as the total is below 50% of the LSE's ALM.[54] While the CPUC would be satisfied with either the 3rd or 4th interpretations, it suggests that the Commission order the CAISO to implement the 4th interpretation because of the greater protection it affords state programs and the opportunity for LSEs to obtain CRRs to hedge transmission from future resources.[55]

The CAISO clarifies that its filed proposal and the associated proposed tariff language

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51 CPUC at 6-7.

52 CPUC at 7-9.

53 CPUC at 6.

54 CPUC at 7.

55 CPUC at 8.

were intended to describe the CPUC's 4th interpretation. In other words, if an LSE's "long term sources" (to use the CPUC's vernacular) are greater than twenty percent (20%) of its ALM and the LSE wants to nominate more than twenty percent of its ALM as Long Term CRRs, then *all* of the LSE's Long Term CRR nominations must come from the LSE's eligible Seasonal CRRs that utilize the "long term sources." Thus, each LSE that is eligible to exceed the twenty percent limit must decide whether to stay within the twenty percent limit, in which case it may nominate any of its eligible Seasonal CRRs as Long Term CRRs, or to exceed the twenty percent limit in which case it may only nominate eligible Seasonal CRRs sourced at its long term sources. The CAISO believes that this interpretation is necessary to address the fundamental concern behind the twenty percent starting point and the gradual increase in successive years, namely, to minimize the incentive and the opportunity "for parties to lock-up a significant portion of grid capacity as long-term CRRs in year one, reducing flexibility for LSEs in later years." *July 6 Order* at P 136. Under the CPUC's preferred interpretation, which is consistent with the CAISO's original intent in crafting its compliance provisions with the *July 6 Order*, an LSE cannot both exceed the twenty percent limit and freely nominate any of its Tier 1-2 Seasonal CRRs as Long Term CRRs. In contrast, under the CPUC's third interpretation above, the LSE could freely nominate as Long Term CRRs what it calculates to be its most valuable Seasonal CRRs up to twenty percent of its ALM, and then nominate CRRs utilizing its long-term sources only for the amount of Long Term CRRs above twenty percent. The CAISO believes that this third interpretation could easily defeat the purpose of the Commission's *July 6 Order* and therefore urges the Commission to accept the preferred interpretation described above. Consistent with the preferred interpretation the CAISO will add the following clarifying sentence to MRTU Tariff § 36.8.3.1.3.1, following the fourth sentence of that section:

> If an LSE's combination of long-term procurement arrangements of ten (10) years or greater and ownership of generation resources is greater than twenty percent (20%) of its Adjusted Load Metric and the LSE nominates more than twenty percent (20%) of its Adjust Load Metric as Long Term CRRs, then the CRR Sources for all of the LSE's Long Term CRR nominations must be sources associated with its demonstrated long-term procurement arrangements of ten (10) years or greater or its owned generation resources.[56]

The CAISO's clarification responds to the comments of SCE and PG&E as well as the CPUC's comments.

#### 4. The CAISO Will Revisit the Issue of a Credit Requirement For CRRs Sold on the Secondary Market When Direct Access Reopens in California

The CPUC does not oppose the CAISO proposal to account for Load Migration between LSEs by issuing equal and opposite CRRs to the two LSEs involved.[57] However, the CPUC is concerned with potential credit risks arising from the allocation of counterflow CRRs to a Load-losing LSE to account for Load Migration.[58] The CPUC explains that it is concerned that a Load-losing LSE might have sold some or all of its initial allocation of CRRs on a secondary market and that such a LSE would be issued counterflow CRRs and would be required to pay the CAISO monthly payments.[59] The CPUC's concern is that the Load-losing LSE would be required to post credit for their counterflow CRRs only when it loses load, not when it sold the CRRs on the secondary market. The CPUC concludes that the credit requirement would be insufficient because it asks for credit to be posted at too late a date and would enable a

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[56] CAISO notes that similar clarifying sentences will be inserted in MRTU Tariff § 36.8.3.5.2.1 (Tier LT for CRR Allocation Beyond CRR Year One). The new sentences will clarify the thirty percent (30%) and forty percent (40%) limitations on Long Term CRR nominations in CRR Year Two and CRR Year Three, respectively, in a manner that is consistent with the interpretation of this limitation for CRR Year One.

[57] CPUC at 13.

[58] *Id*. at 14.

[59] *Id*.

convenient exit strategy for LSEs nearing bankruptcy.[60]

The CPUC states that the remedy is to establish a credit requirement due at the time of the sale of an allocated CRR.[61] Recognizing that determining the appropriate level of credit is a complex process, the CPUC recommends that the CAISO's "risk assessment organization" conduct a review of the risks posed to the CRR balancing account that arise from the lack of a credit requirement and to propose a solution to avoid the effects described by the CPUC.[62] Finally, the CPUC indicates that the CAISO has opposed such a credit requirement in the past but has stated that it will revisit this issue if direct access reopens in California. The CPUC believes the risk will increase if direct access reopens in California. Therefore, the CPUC requests that if its initial remedy (*i.e.*, a review of the credit risk and the CAISO proposing a solution) is denied, that the Commission direct the CAISO to include tariff language providing that the CAISO will revisit the issue of credit requirements if direct access reopens in California.[63]

The CPUC is correct that CAISO has opposed the establishment at the present time of an additional credit requirement to be applied at the time of the sale by an LSE of an allocated CRR. The additional credit requirement would be structured to cover the potential payment stream that the LSE would be required to pay the CAISO for any offsetting CRRs it was assigned by the CAISO in conjunction with migration of Load away from that LSE to another LSE. Although the CAISO understands the logic for such an additional credit requirement, the CAISO has explained that the limited potential impact of the concern raised by the CPUC under the current

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60 *Id*.

61 *Id*. at 17.

62 *Id*.

63 *Id*.

rules (including both the statutory limitations on direct access load migration as well as the CAISO's rules limiting the bilateral sales of Long Term CRRs) does not justify the potentially substantial complexity involved in designing and implementing an additional credit requirement at this time. However, the CAISO commits to revisit the issue in the future if direct access in California is significantly expanded or sooner, upon indication that the risks between LSEs, on the one hand, who would bear a potentially significantly increased credit requirement if they are required to post security upon the sale of a Long Term CRR, and CAISO creditors, on the other hand, that would bear risk of defaults for under-secured obligations, are not appropriately balanced.

### B. Issues Relating to Ensuring Consistency Between Monthly Load Forecasts Submitted for Resource Adequacy Purposes and Those Submitted for CRR Allocation Purposes

In the *July 20 Compliance Filing* the CAISO explained that the CAISO has an existing obligation in the MRTU Tariff to work closely with state and Local Regulatory Authorities to ensure that the historical Load data and the Load forecasts that are used to establish Seasonal and Monthly CRR Eligible Quantities are consistent with the data and forecasts used to establish Resource Adequacy requirements.[64] The CAISO discussed how to ensure greater consistency among the load forecasts with stakeholders and, while most of the details will reside in the BPMs, the CAISO proposed a minor revision to Section 36.8.2.2 to reflect its authority to modify an LSE's Monthly CRR Eligible Quantity if necessary to ensure the consistency between LSE Load forecasts used to establish Monthly CRR Eligible Quantities and the forecasts used to establish resource adequacy requirements.

In its comments AReM states that it understands and supports the CAISO's interest in

[64] *See July 20 Compliance Filing* at 12-13 and MRTU Tariff § 36.8.6.

ensuring consistency between monthly load forecasts submitted for Resource Adequacy and those submitted for CRR allocation.[65] AReM says that it discussed its concerns with the CAISO and stakeholders and is willing to move forward with the current proposal with the understanding that the CAISO will include a provision in its BPM that would accept, for CRR allocation purposes, revised Resource Adequacy load forecasts from LSEs after they have been verified by the California Energy Commission. AReM at 4. As described in the *July 20 Compliance Filing* the CAISO will use the revised non-coincident peak load forecasts supplied to the CEC for Resource Adequacy purposes on a monthly basis 60 days prior to the start of the relevant month.[66] The CAISO's use of the revised non-coincident peak load forecasts supplied to the CEC for Resource Adequacy purposes satisfies AReM's request.

### 1. SWP's Eligibility for Monthly CRRs

The CAISO explained in the *July 20 Compliance Filing* that CPUC-jurisdictional LSEs provide revised non-coincident peak load forecasts to the CEC on a monthly basis 60 days prior to the start of the relevant month.[67] For non-CPUC jurisdictional LSEs, CEC currently receives only the year-ahead monthly non-coincident peak load forecast values to support its annual supply adequacy report.[68] The CAISO indicated that for consistency purposes it will use the 60-day ahead forecasts from the CEC for CPUC-jurisdictional LSEs, and the year-ahead forecasts from the CEC for the non-CPUC jurisdictional LSEs.[69] SWP states that although it is not a CPUC-jurisdictional LSE, it submits updated monthly forecasts to the CEC similarly to CPUC-

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65 AReM at 3.

66 *July 20 Compliance Filing* at 20.

67 *Id*.

68 *Id*.

69 *Id*.

jurisdictional LSEs.[70] Consequently, SWP argues that it should be allowed to use its updated 60-day-ahead resource adequacy forecasts supplied to the CEC.[71] The CAISO does not object to SWP using the updated 60-day ahead resource adequacy forecasts it supplies to the CEC for the purposes of determining its eligibility for Monthly CRRs, provided that the CEC actually receives and verifies SWP's submissions in a time frame compatible with the CAISO's monthly CRR process.

### 2. Adjusted Load Metric for SWP using Five Year Average Historical Load Information

In the *July 20 Compliance Filing* the CAISO noted that it has continued to work with employees of the SWP in the collection of data necessary to determine the SWP's Load Metric for CRR allocation purposes.[72] The CAISO stated that it provided SWP with the option to use the five year average historical load information and that it will include this option in its BPM for CRRs.[73]

SWP supports the CAISO's modifications to allow the use of a five year historical load average for CRR allocations and, as a separate matter, to confirm that Participating Load which is settled nodally is eligible for the PNP.[74] SWP states that it appreciates the CAISO's recognition that SWP's pumping loads, which can vary widely as hydrological conditions change, require consideration of a different historical usage than relatively reliable LSE loads based on retail demand.

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70 SWP at 4.

71 *Id*. at 5.

72 *July 20 Compliance Filing* at 21.

73 *Id*.

74 CDWR at 6-8.

SCE states that the CAISO's treatment of the Load Metric for SWP must be contained in the tariff and requires further clarification.[75] SCE believes that the CAISO's proposal provides SWP with a "free option" that is not afforded to any other market participant.[76] In other words, SCE says the proposed language appears to allow SWP, on a year by year basis, to select either its five-year average historical load or its prior year's historical load to determine its ALM.[77] SCE reasons that the logical choice would be for SWP to always select the larger of those two data points in order to maximize its CRR allocation.[78]

The CAISO agrees with SCE that SWP's need for a stable basis for calculating CRR eligibility does not require that SWP have the option each year to choose between five-year average historical load or its prior year's historical load. The CAISO agrees that for non-conforming loads such as SWP's that are subject to variable and hard-to-predict hydrological conditions, it is appropriate to use the rolling five year average historical load data for calculating the Load Metric, because the five year historical average will tend to provide a more stable, normalized picture of their actual need than relying only on the most recent year's data. One concern is that if the most recent year happened to be a high-water year while the upcoming CRR year turns out to be a low-water year, the resulting Load Metric will result in an allocation of CRRs which could be above SWP's actual need and could thereby unfairly disadvantage other LSEs in the allocation process. In such instances the CAISO would likely need to reduce SWP's Load Metric for the monthly CRR allocation, and in extreme cases the Seasonal CRRs awarded to SWP in the annual process based on the historical high-water year could even exceed the

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75 SCE at 8-9.

76 SCE at 9.

77 *Id*.

78 *Id*.

quantity of CRRs SWP is eligible for in certain months based on the forecast for that month. Rather than try to develop complicated rules and mitigation procedures to deal with such potential outcomes, the CAISO believes that basing SWP's Load Metric for annual CRR allocation on the most recent five years of historical load data will make it extremely unlikely that such over-allocations will occur. Therefore, the CAISO proposes to include in its tariff clarifying language which would implement the five year historical average in its determination of SWP's Load Metric, which would apply in all years and would not provide SWP an opportunity to elect on a year-to-year basis whether to use the five-year average or the most recent year.

### C. The Comments of SMUD and IID Regarding the Source Verification Requirements for OCALSE's Are Objections to the Determinations in the Commission's *July 6 Order* .

The comments of SMUD and IID are focused entirely the source verification requirements approved in the *July 6 Order*.[79] For example, SMUD argues that the requirements approved by the Commission regarding a forward-looking showing of need are unnecessary "overkill" because there are sufficient requirements in place.[80] Similarly, IID claims the CRR source verification requirements for external LSEs are "unnecessary."[81]

The principle complaint is the requirement in § 36.8.3.4.2 that all CRR nominations by Qualified OCALSEs must be source verified.[82] However, the requirement is in response to the Commission direction. The Commission stated:

We find that, if external LSEs meet the requirements set forth in the MRTU Tariff

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79 SMUD at 3-6; IID at 5-10.

80 SMUD at 4.

81 IID at 7-9.

82 *See*, *e.g.*, SMUD at 3; IID at 5.

> and demonstrate *their continuing commitment both to utilize the CAISO transmission grid to serve their load* and *to contribute to the embedded costs of the transmission system*, external LSEs should be permitted to participate in the CRR allocation process in a manner similar to internal LSEs.

*July 6 Order* at P 188. With regard to the ability of the CAISO and the Commission to verify and OCLASE's on-going reliance on the CAISO transmission system, the Commission stated:

> We recognize the concerns raised by both the CAISO and protestors that these CRR nominations must be tied to the congestion charges that external LSEs actually incur when serving their load. We also recognize that import capacity and the ability to hedge congestion costs at interties is critically important to internal LSEs. As discussed in prior orders, the allocation of CRRs is intended to provide LSEs with a means to hedge congestion costs incurred while using the CAISO transmission system to serve their load. Furthermore, external LSEs are situated differently than internal LSEs because external LSEs may have the option of not using the CAISO transmission system. *Therefore, in order to support the CAISO in the process of evaluating whether external LSEs are utilizing its system, we accept the CAISO request to modify its proposal, in response to SoCal Edison's concerns, to incorporate a mechanism through which it can verify an external LSE's on-going reliance on the CAISO transmission system. We find that the inability to verify on-going usage of the transmission system could result in the allocation of wheel-through CRRs to external entities that are no longer using the CAISO transmission system to serve their load, which is inconsistent with allocating CRRs to LSEs to hedge the actual congestion cost they incur. Accordingly, we find that the CAISO's proposal to apply the "forward-looking showing to all CRR nominations" in conjunction with MRTU Tariff section 36.9.3 is just and reasonable*.
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> *July 6 Order* at P 189 (emphasis added; citations omitted).

The tariff provisions to which SMUD and IID complain are in compliance with Commission determinations in the *July 6 Order*.[83] Consequently, the comments are better addressed as rehearing requests of the *July 6 Order*.

## D. Answer to SDG&E Request for Rehearing Regarding the Treatment of Seller's Choice Contracts for Purposes of CRR Source Verification.

In its Request for Rehearing of the *July 6 Order*, San Diego Gas & Electric Company

[83] *See July 6 Order* at PP 188-189.

("SDG&E") argued that the Commission's prior refusal to further accommodate SDG&E's concern in the Commission's *July 6 Order* is arbitrary and capricious because of the CAISO's implementation of its source verification rules as they pertain to Seller's Choice contracts.[84] As explained by SDG&E, under a "Seller's Choice" contract, the supplier has the right to deliver energy to the buyer either at the particular source that will be used to produce the power delivered under the contract or one of the CAISO-defined aggregated pricing nodes (*i.e.*, the Default LAPs and EZGen Trading Hubs). SDG&E correctly reports that the CAISO's practice as developed over the past several months has been to accept sworn statements by holders of seller's choice contracts declaring that such LSEs have the right to nominate certain sources for CRR allocation because they have the right to submit Bids or Self-Schedules at specific locations pursuant to these contracts. SDG&E asserts, however, that this practice varies from the CAISO's intended rationale for using 2006 as a baseline and therefore the Commission's prior refusal to grant SDG&E relief is arbitrary and capricious. The CAISO respectfully requests leave to answer this assertion.

The CAISO's practice as developed in most recent months to implement the source verification with regards to seller's choice contracts does not vary from the CAISO's stated purpose for using the historical year and its reliance on legally binding declarations of the LSE's rights to specific sources as specified in its tariff and approved by the Commission. The CAISO has previously stated and the Commission has agreed that the purpose of the historical period is that, by "basing the CRR allocation on a period that has already occurred, the CAISO avoids the potential for the allocation process to distort going-forward contracting or operating

[84] *See* SDG&E Request for Rehearing of the *July 6 Order* at 16-18.

incentives."[85] In allowing the holders of such seller's choice contracts to assert their right to nominate CRRs from specific sources based on their contracts during the historical period, the CAISO does not in any way undermine the objective of ensuring that holders of such contracts are unable to adjust their contracting and operating incentives to attempt to obtain more valuable CRRs.

Further, the CAISO has developed and the Commission has approved a source verification process that requires parties to attest to their right to nominate a particular source based on their right to schedule from a particular source during the historical period based on ownership or contracts rights held by the LSE.[86] Consistent with this policy, the CAISO has accepted declarations by holders of seller's choice contracts that stipulate that these LSEs have the right to schedule from specific sources permitted under the contracts. These contracts indeed do allow the seller to select any actual generation source in the designated area as well as one of the aggregated pricing nodes. As such, if the contract stipulates that it will be sourced at NP 15, the seller may select any generation source in NP 15, or may deliver the energy to the buyer at the NP15 EZGen Trading Hub to fulfill the contractual requirements. Consequently, going forward, an LSE that holds such contracts will not be able to predict which source precisely it will receive service from under the contract, but will continue to be subject to Congestion Charges under the CAISO contracts based on the actual physical Pricing Node or aggregated pricing node from which it will schedule its supply pursuant to such contracts. By allowing the LSE to select its sources based on its declaration of its rights under their contracts, the CAISO is providing holders of such rights the opportunity to ensure its use of the contract receives

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85 *September 2006 Order* at PP 813-814.

86 *See* MRTU Tariff § 36.8.3.4; *See also*, LECG Testimony submitted February 9, 2006, page 91.

adequate protection against congestion. The CAISO fails to see what other reasonable alternative exists in applying the source verification rules to holders of such contracts without eroding the LSE's ability to be allocated sufficient CRRs to manage the congestion costs associated with deliveries of energy under these contracts. Any limitation on the sources eligible for CRR allocation that is more restrictive than the sources that may be specified by the seller under such contracts would force the holders of such contracts to face potential exposure to congestion when actually using these contracts.

## III. CONCLUSION

Wherefore, the CAISO respectfully requests that the Commission: (i) accept the *July 20 Compliance Filing* as proposed and as discussed herein without suspension or hearing, and (ii) deny SDG&E's request for rehearing regarding the CAISO's implementation of its source verification rules as they pertain to seller's choice contracts.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned docket.

Dated at Folsom, California on this 27th day of August, 2007.

/s/ Anna A. McKenna

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