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January 24, 2006

VIA ELECTRONIC FILING

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

Re: California Independent System Operator Corporation
Docket Nos. ER06-354-___ and EL06-44-___

Dear Secretary Salas:

Attached please find the Motion for Clarification or, in the Alternative, Request for Rehearing and Motion for Stay, of the California Independent System Operator Corporation, submitted in the captioned dockets.

Please contact the undersigned in this matter.

Respectfully submitted,

_/s/ Bradley R. Miliauskas_____
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Counsel for the California Independent System Operator Corporation

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	Docket Nos. ER06-354-___ and EL06-44-___

MOTION FOR CLARIFICATION OR, IN THE ALTERNATIVE, REQUEST FOR REHEARING AND MOTION FOR STAY, OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Section 313(a) of the Federal Power Act ("FPA"), 16 U.S.C. § 825l(a) (2000), and Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.713 (2005), the California Independent System Operator Corporation ("CAISO")[1] submits this motion for clarification or, in the alternative, request for rehearing and motion for stay, concerning the Commission's "Order Accepting and Modifying Tariff Filing and Instituting a Section 206 Proceeding," 114 FERC ¶ 61,026, issued in the captioned proceeding on January 13, 2006 ("Amendment No. 73 Order"), which accepted in part and modified in part Amendment No. 73 to the CAISO Tariff ("Amendment No. 73"). For the reasons explained below, the Commission should: (i) clarify that the Amendment No. 73 Order was not intended to require the CAISO to change the existing Commission-approved "hard" cap on Adjustment Bids to a "soft" cap, or, (ii) in the alternative, if the Commission intended to require the CAISO to change the cap on Adjustment Bids to a soft cap, the Commission should: (a) grant rehearing on that issue and allow the

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

CAISO to retain the existing hard cap on Adjustment Bids because the Commission has no basis for concluding that such a change is justified, and (b) grant a stay of the directive to change to a soft cap on Adjustment Bids.

I. STATEMENT OF ISSUES

In accordance with Rules 203(a)(7) and 713(c)(2), 18 C.F.R. §§ 385,203(a)(7), 385.713(c)(2), the CAISO provides this Statement of Issues.

1. Whether the Commission should clarify that it intended for the CAISO to retain a hard cap on Adjustment Bids rather than changing that cap to a soft cap, given that: (a) the substantive discussion of soft caps in the Amendment No. 73 Order pertains to the existing soft cap on Energy bids not the existing hard cap on Adjustment bids, and nothing indicates that the Commission intended for the CAISO to change its existing hard cap on Adjustment Bids to a soft cap; (b) consistent with prior Commission orders, the CAISO has applied a hard cap to Adjustment Bids since inception, including when Energy bids changed to a "soft cap" during the California energy crisis (*San Diego Gas & Electric Co.*, 97 FERC ¶ 61,275, at 62,232-33 (2001), and *San Diego Gas & Electric Co.*, 97 FERC ¶ 61,293, at 62,362 (2001), and the CAISO did not propose to change that practice in Amendment No. 73; and (c) any ambiguity in the Amendment No. 73 Order solely arises from the Order's reiteration of misstatements in the CAISO's transmittal letter for Amendment No. 73 concerning the nature of the existing cap on Adjustment Bids.[2]

2. Whether the Commission, if it does not grant the requested clarification (1), above, should find on rehearing that the CAISO should apply a hard cap rather than a soft cap to Adjustment Bids, given that: (a) any directive to implement a soft cap on Adjustment

[2] The ambiguity in the Amendment No. 73 Order is created solely by two instances where the Order repeats a misstatement from the CAISO's transmittal letter for Amendment No. 73 that the then-current caps were a "'soft' bid cap of $250/MWh for real-time energy bids *and* adjustment bids." Amendment No. 73 Order at PP 1, 3 (emphasis added); *see also* Amendment No. 73 Transmittal Letter at 1, 2, 5. However, the existing cap on Adjustment Bids is a hard cap not a soft cap. The CAISO apologizes for any confusion it may have created through this misstatement in the transmittal letter.

Bids was based on a misunderstanding of the facts concerning the nature of the existing cap on Adjustment Bids (due to the CAISO's misstatement in the Amendment No. 73 transmittal letter which was referenced in the Amendment No. 73 Order); (b) the Commission has no basis in the record to conclude that the existing hard cap on Adjustment Bids approved in prior Commission orders (*San Diego Gas & Electric Co.*, 97 FERC ¶ 61,275, at 62,232-33 (2001), and *San Diego Gas & Electric Co.*, 97 FERC ¶ 61,293, at 62,362 (2001)) is unjust and unreasonable; and (c) the Commission has no basis in the record to conclude that a soft cap on Adjustment Bids is justified.

3. If the Commission intended to require that the CAISO implement a soft cap for Adjustment Bids in the Amendment No. 73 Order, whether the Commission should grant a stay of this requirement given that the CAISO will suffer irreparable injury without a stay, issuing a stay will not substantially harm other parties, and granting a stay is in the public interest. *See CMS Midland, Inc. v. Midland Cogeneration Venture Limited Partnership*, 56 FERC ¶ 61,177, at 61,631 (1991), *aff'd sub nom. Michigan Municipal Cooperative Group v. FERC*, 990 F.2d 1377 (D.C. Cir.), *cert. denied*, 510 U.S. 990 (1993). *See also, e.g., City of Tacoma*, 87 FERC ¶ 61,197 (1999).

II. BACKGROUND

The CAISO submitted Amendment No. 73 on December 21, 2005. In Amendment No. 73, the CAISO proposed to revise the CAISO Tariff to modify the "Damage Control Bid Cap" (or "bid cap"), which sets a limit on the level of bids submitted into the CAISO's Energy markets. Specifically, the CAISO proposed to change the "soft" $250/MWh bid cap applicable to real-time Energy bids to a "hard" $400/MWh bid cap, effective as of January 1, 2006 or as soon thereafter as possible. Transmittal Letter for Amendment No. 73 at 5-6.[3] The transmittal letter also explained that a $250/MWh bid cap was applicable to

[3] Under a "soft" bid cap regime, Market Participants are allowed to submit above-cap bids, but such bids do not set the Market Clearing Price. Under a "hard" bid cap, Market Participants are forbidden from submitting above-cap bids. Transmittal Letter for Amendment No. 73 at 2.

Adjustment Bids used in the Day-Ahead and Hour-Ahead Congestion Management markets and indicated that the CAISO was also proposing to raise the bid cap for Adjustment Bids to $400/MWh. *Id.* at 2. In the transmittal letter, the CAISO mistakenly referred to a current soft cap on real-time Energy bids *and* Adjustment bids. *Id.* at 1. As discussed below, the existing cap on Adjustment Bids is a hard cap, not a soft cap.

In the Amendment No. 73 Order, the Commission stated that it "accepts the CAISO's proposal to raise the current bid cap from $250/MWh to $400/MWh." Amendment No. 73 Order at P 25. The Commission went on to state that it "rejects, however, the CAISO's proposal to change the current 'soft' nature of the cap to a 'hard' cap during this interim period prior to the implementation of MRTU [the Market Redesign & Technology Upgrade] and a resource adequacy mechanism." *Id.* at P 26. The Commission stated that "[n]either the MSC [Market Surveillance Committee] nor DMM [Department of Market Monitoring] recommended changing the cap from a 'soft' to a 'hard' cap, and the CAISO has not adequately supported such a change." *Id.* at P 26. The Commission indicated that it would "retain the cap as a 'soft' cap during this interim period" until the implementation of MRTU. *Id.* In the Ordering Paragraphs, the Commission directed that it "accepts and modifies the CAISO's proposal to adjust its bid cap for real-time energy bids and adjustment bids to $400/MWh, as discussed within the body of the order." Amendment No. 73 Order at Ordering Paragraph (A). Taken as a whole, the Commission statements quoted above direct the CAISO to raise the cap applicable to Energy bids and Adjustment Bids to $400/MWh. Although the relevant paragraphs of the Amendment No. 73 Order focus on retaining the existing "soft" cap on Energy bids, the CAISO is submitting this filing to address concerns that the Order could be construed to make the cap on *both* Energy bids *and* Adjustment Bids a soft cap rather than a hard cap.

III. MOTION FOR CLARIFICATION

The Commission should clarify that it intended for the CAISO to retain the existing hard cap on Adjustment Bids rather than change the cap to a soft cap.

Since inception the CAISO has applied a hard cap on Adjustment Bids. Even when the CAISO implemented a soft cap for Energy bids during the energy crisis, the cap on Adjustment Bids remained a hard cap. This fact is well understood by Market Participants. The CAISO's systems reject all Adjustment Bids that Market Participants submit that are over the cap – the hallmark of a hard cap rather than a soft one. The Commission has accepted this practice in prior orders.[4] In Amendment No. 73, the CAISO did not propose to change the existing hard cap on Adjustment Bids to a soft cap.

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[4] In the proceeding concerning Amendment No. 33 to the CAISO Tariff, in which the CAISO first proposed a soft price cap on Energy bids, the CAISO explained that the soft cap it proposed did not apply to Adjustment Bids. Instead, the CAISO proposed to continue to apply "the existing $250 hard cap on Adjustment Bids," though with certain changes to the way that Adjustment Bids were formulated and processed by the CAISO and the California Power Exchange ("PX") (which was in operation at the time). *See* Limited Motion for Clarification of the CAISO and Answer to the California Power Exchange's Motion for Emergency Expedited Modification of Amendment No. 33, Docket No. ER01-607-001 (Dec. 11, 2000), at 7-12 ("December 11, 2000 CAISO Filing").

Later, in a filing in Docket Nos. EL00-95-008, *et al.*, submitted in compliance with the Commission's December 15, 2000 "Order Directing Remedies For California Wholesale Electric Markets," 93 FERC ¶ 61,294 (2000), the CAISO reiterated that it "believes that it is appropriate to retain a 'hard' cap on Adjustment Bids submitted as part of its Congestion Management process." CAISO Compliance Filing, Docket Nos. EL00-95-008, *et al.* (Jan. 2, 2001), at 6 ("January 2, 2001 CAISO Filing"). The Commission, in its order addressing, *inter alia*, the December 11, 2000

Ordering Paragraph (A) of the Amendment No. 73 Order "accepts and modifies the CAISO's proposal to adjust its bid cap for real-time energy bids and adjustment bids to $400/MWh, as discussed within the body of the order." Neither the Ordering Paragraphs of the Amendment No. 73 Order nor the substantive discussion of the CAISO's bid caps in Paragraphs 25 and 26 of the Order state that the Adjustment Bid cap should be changed from a hard cap to a soft cap. Rather, Paragraph 25 of the Order discusses the then "current $250/MWh 'soft' bid cap in the CAISO's energy market" without reference to Adjustment Bids in the CAISO's Congestion Management markets. Paragraph 26 rejects the proposal to change the existing soft cap (*i.e.*, the soft cap on Energy bids) to a hard cap:

> The Commission rejects, however, the CAISO's proposal to change *the current* 'soft' nature of the cap to a 'hard' cap during this interim period prior to the implementation of MRTU and a resource adequacy mechanism. . . . we will *retain* the cap as a 'soft' cap during the interim period.

This language suggests that the Commission's objective was to maintain the *status quo* concerning the hard or soft nature of the CAISO's bid caps pending

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CAISO Filing and the January 2, 2001 CAISO Filing, stated that the accommodations described in the January 2, 2001 CAISO Filing "resolved the adjustment bid issue." *See San Diego Gas & Electric Co.*, 97 FERC ¶ 61,275, at 62,232-33 (2001). Concurrently, the Commission issued an order accepting the January 2, 2001 CAISO Filing in relevant part, accepting the continued application of a hard cap on Adjustment Bids. *San Diego Gas & Electric Co.*, 97 FERC ¶ 61,293, at 62,362 (2001).

As the Commission noted in the Amendment No. 73 Order, "[i]n a July 2002 Order, the Commission established a bid cap of $250/MWh for the California real-time energy and ancillary services markets, to become effective on October 1, 2002, as recommended by the CAISO's MSC." Amendment No. 73 Order at P 8, *citing California Independent System Operator Corp.*, 100 FERC ¶ 61,060, at P 46 (2002). The Commission later clarified that the CAISO was to continue its practice of applying a soft cap to Energy and Ancillary Service bids. When the new $250/MWh cap level was implemented in 2002, the CAISO continued its pre-existing practice of applying a hard cap to Adjustment Bids.

MRTU implementation. Stated differently, the discussion in the relevant paragraphs of the Amendment No. 73 Order suggests that the Commission merely intended to retain the existing soft cap on Energy bids, not approve a **new** soft cap for Adjustment Bids.

Any ambiguity in the Amendment No. 73 Order arises solely from the two instances where the Order repeats a misstatement from the Amendment No. 73 transmittal letter that the then-current caps were a "'soft' bid cap of $250/MWh for real-time energy bids *and* adjustment bids." Amendment No. 73 Order at PP 1, 3 (emphasis added). In that regard, the transmittal letter stated that the CAISO proposed to "replace the current $250/MWh soft bid cap on real-time Energy bids and Adjustment Bids with a $400/MWh hard cap." Amendment No. 73 Transmittal Letter at 5; s*ee also id.* at 1, 2. A more accurate wording of that sentence – rather than the confusing shorthand language used in the transmittal letter – would have made clear that the CAISO actually proposed to "replace the current $250/MWh soft bid cap on real-time Energy Bids and *the current hard cap on* Adjustment Bids with a $400/MWh hard cap." The CAISO regrets any confusion that this misstatement may have created. The Commission should confirm that its reiteration of this misstatement in the Amendment No. 73 Order was not intended to direct a substantive change in the nature of the CAISO's Adjustment Bid cap from the long-standing hard cap to a soft cap.

As noted above, the substantive discussion in the Amendment No. 73 Order focuses on the reasons why a soft cap for real-time Energy bids should not be converted to a hard cap at this time. The Commission found that the CAISO had not "adequately supported" a change to the "soft" nature of the existing cap on energy bids and directed the CAISO to "retain" this cap as a "soft" cap. Amendment No. 73 Order at P 26. Presumably, the Commission's objective was to maintain the *status quo* of the existing nature (soft or hard) of the CAISO's bid caps pending MRTU implementation. Consistent with this objective, the Commission should clarify that the Amendment No. 73 Order was not intended to require a change to that *status quo*, by changing the existing hard cap on Adjustment Bids to a soft cap.

IV. ALTERNATIVE REQUEST FOR REHEARING AND SPECIFICATION OF ERROR

If the Commission does not grant the requested clarification, then the Commission should grant rehearing of the Amendment No. 73 Order. To the extent the Commission treats the instant filing as a request for rehearing rather than a motion for clarification, the CAISO submits, pursuant to Rule 713(c)(1), 18 C.F.R. § 385.713(c)(1), that the Amendment No. 73 Order erred in the following respects: (a) any directive to implement a soft cap on Adjustment Bids is based on a misunderstanding of the facts concerning the nature of the existing cap on Adjustment Bids as a result of the misstatement in the CAISO's transmittal letter; (b) the Commission has no basis in the record to conclude that the existing hard cap on Adjustment Bids approved in prior Commission orders (*San Diego Gas & Electric Co.*, 97 FERC ¶ 61,275, at 62,232-33 (2001), and *San Diego Gas & Electric Co.*, 97 FERC ¶ 61,293, at 62,362 (2001)) is unjust and unreasonable; and (c) the Commission has no basis in the record to conclude that a soft cap on

Adjustment Bids is justified. For the reasons discussed below, the Commission should find that the CAISO should apply a hard cap rather than a soft cap to Adjustment Bids.

A. The Discussion of Adjustment Bid Caps in the Amendment No. 73 Order is Based On a Misunderstanding of the Nature of Those Caps.

As explained above, since inception the CAISO has applied a hard cap to Adjustment Bids and has never applied a soft cap to Adjustment Bids. The CAISO did not propose to change this approach in Amendment No. 73. To the extent that the Amendment No. 73 Order was intended to require implementation of a soft cap on Adjustment Bids, that Order was, by all indications, based on a misunderstanding of the facts concerning the existing Adjustment Bid cap. Although the CAISO inadvertently created this misunderstanding, there is no reason why the Commission should continue to impose a requirement based on mistaken facts.[5]

B. The Commission Has No Basis to Conclude That the Existing Hard Cap on Adjustment Bids Is Unjust and Unreasonable.

The Commission has found that the hard cap on Adjustment Bids currently applied by the CAISO is just and reasonable. *San Diego Gas & Electric Co.*, 97 FERC ¶ 61,275, at 62,232-33 (2001), and *San Diego Gas & Electric Co.*, 97 FERC ¶ 61,293, at 62,362 (2001). In order to require a public utility like the

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[5] *See, e.g.*, *Cities of Anaheim, Azusa, Banning, Colton, and Riverside v. California Independent System Operator Corp.*, 102 FERC ¶ 61,274, at PP 15, 42, 46 (2003), *order on reh'g*, 105 FERC ¶ 61,021 (2003), *order on reh'g*, 106 FERC ¶ 61,205 (2004), *aff'd in relevant part sub nom. IDACORP Energy L.P. v. FERC*, ___ F.3d ___, ___, 2006 U.S. App. LEXIS 519, at *5-*9 (D.C. Cir. Jan. 10, 2006) (finding on rehearing, pursuant to clarifying information provided by the CAISO, that provisions in the CAISO Tariff concerning neutrality adjustment charges do not apply to out-of-market charges and other charges not specifically listed in those CAISO Tariff provisions).

CAISO to modify a rate, term, or condition in its tariff previously found to be just and reasonable, the Commission must first conclude that the approved rate, term, or condition is unjust and unreasonable in accordance with Section 206 of the Federal Power Act ("FPA"). *See, e.g.*, *Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002); *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 703 (D.C. Cir. 2000). However, the Commission has not expressly found the existing hard cap to be unjust and unreasonable. Further, the Commission has no record before it as to any issues or concerns with respect to changing the current hard cap on Adjustment Bids. In particular, there is no evidence before the Commission that that existing hard cap on Adjustment Bids has been or is problematic. Indeed, the Commission has expressly found that a change to the existing nature (hard or soft) of the CAISO's bid caps has not been "adequately supported." Amendment No. 73 Order at P 26. Because there is no basis to conclude that the CAISO's long-standing approach of applying a hard cap to Adjustment Bids and a soft cap to Energy bid caps is unjust and unreasonable, there consequently is no basis to require the CAISO to change the hard cap on Adjustment Bids to a soft cap.

C. The Commission Has No Basis to Conclude That a Soft Cap on Adjustment Bids Is Justified.

In order to direct a change to a soft cap on Adjustment Bids under the FPA, the Commission must also conclude that such a soft cap is just and reasonable. The Commission has no basis in the record to support such a finding. Neither the CAISO nor any other party has considered the impacts of changing the Adjustment Bid hard cap to a hard cap and potential unintended consequences of such a change.

Because the CAISO did not intend to propose to change from a hard cap to a soft cap for Adjustment Bids, the CAISO has not investigated all of the potential implications of such a change and has not considered in detail all potential unintended consequences associated with such a change. However, the CAISO's initial review of this issue prior to making this filing indicates that having a soft cap on Adjustment Bids could result in unanticipated detrimental market impacts, inefficient results, and potential gaming opportunities. An example of just one of the detrimental market impacts that would result from a soft cap for Adjustment Bids is provided in Attachment B hereto. Another potential source of detrimental market impacts and gaming under a soft cap for Adjustments Bids is that Adjustment Bids can be used to trigger counterflow schedules that get paid for Congestion relief by, in effect, creating increased transmission capacity in the other (congested) direction.[6]

If the CAISO were required to implement a soft cap for Adjustment Bids, it would need to resolve numerous complexities and unresolved issues before it could implement such soft cap. The principle of a soft cap is that bids may be accepted (and ultimately paid) at prices over the soft cap, but that any bids over the soft cap do not set the Market Clearing Price. Applying the concept of a soft cap to Adjustment Bids is highly problematic, largely because Adjustment Bids are not actually accepted individually, and Congestion prices are not set by

[6] Counterflows result when Scheduling Coordinators have schedules in the opposite direction of Congestion.

individual Adjustment Bids. Rather, Adjustment Bids must be accepted in combination with one or more other Adjustment Bids submitted by the same Scheduling Coordinator, with Congestion prices being set based on the maximum difference between the prices of different Adjustment bids accepted from each Scheduling Coordinator. In other words, an Adjustment Bid to increase generation, increase imports, or decrease exports can only be accepted in conjunction with one or more Adjustment Bids to decrease generation, decrease imports, or increase exports.[7] Congestion prices are based on the difference in the price of Adjustment Bids dispatched within each Scheduling Coordinator's portfolio, rather than the price of any individual Adjustment Bid.[8] However, the specific pairs of Adjustment Bids that actually set Congestion prices are not specifically identified in the Congestion Management software.

The key issues and problems that would need to be addressed and resolved before the CAISO could implement a soft cap for Adjustment Bids include those described below and those indicated in the Affidavit of Deborah A. Le Vine, Attachment A hereto.

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7 This requirement of the CAISO's Congestion Management software reflects the overall balanced scheduling requirement underlying the CAISO's market design, which requires that each Scheduling Coordinator's portfolio of scheduled supply and demand remain balanced.

8 The method for determining the Congestion price is illustrated by the following highly simplified scenario: A Scheduling Coordinator could have an Adjustment Bid of $600/MWh to increase supply on the congested side of a transmission path that is accepted in conjunction with an Adjustment Bid of $400/MWh to decrease supply on the opposite side of the transmission path, the result being a net price of $200/MWh. A second Scheduling Coordinator could have an Adjustment Bid of $600/MWh to increase supply on the congested side of a transmission path that is accepted in conjunction with an Adjustment Bid of $0/MWh to decrease supply on the opposite side of the transmission path, the result being a net price of $600/MWh. Under this simplified scenario, the Congestion price would be set by the $600/MWh difference in bid prices of the second Scheduling Coordinator's Adjustment Bids.

1. The Means of Applying a Soft Cap to Adjustment Bids and Managing Congestion Under Such a Cap Would Need to Be Determined.

Because Congestion prices are based on the difference in the price of two or more Adjustment Bids dispatched within each Scheduling Coordinator's portfolio, rather than the price of any individual Adjustment Bid, the concept of a soft cap on Adjustment Bids cannot be applied to the Congestion markets by simply truncating Congestion prices at the $400/MWh level, and the charging or paying of any Adjustment Bid over $400/MWh based on the price bid. In practice, attempting to apply a soft cap to Adjustment Bids might require multiple runs of the Congestion Management software in order to calculate Congestion prices that would result if an Adjustment Bid in excess of the $400/MWh soft cap were not allowed to set the congestion prices. Due to the wide range of issues and options that would need to be addressed if the CAISO were required to develop a soft cap for Adjustment Bids, the CAISO has not attempted to provide an exhaustive list of such issues and options. Instead, the CAISO simply notes that significant time and resources would be needed to identify and assess such issues and options and the numerous settlement details involved with them. Most importantly, however, the CAISO believes that any of these approaches could create a disconnect between Congestion prices and bid prices that could have significant detrimental impacts on market equity and efficiency. A simple example discussing such detrimental impacts is provided in Attachment B hereto.

Also, it is unclear how Congestion would actually be managed if a soft cap applied to Adjustment Bids. As an example, if the CAISO applies a soft cap of

$400/MWh to Adjustment Bids, but a unit bids $600/MWh, the CAISO would have to decide whether to: (1) resolve Congestion using the $600/MWh bid and then, if the Commission determines that the bid was not valid, then credit the Scheduling Coordinator who paid too much; or (2) resolve Congestion using a $400/MWh capped bid and then, if the bid is subsequently deemed to be valid, pay $600/MWh. The second approach raises issues if the Load had not agreed to pay that amount. This issue must be resolved before a soft cap can be implemented.

2. Problems and Issues Relating to Cost Allocation Would Need to Be Addressed.

A variety of cost allocation issues also would need to be addressed in order to charge or pay Market Participants with Adjustment Bids whose bid prices are in excess of the soft cap, while at the same time ensuring equitable results with regard to other Market Participants and avoiding the creation of gaming opportunities. One complicating factor with a soft cap to Adjustment Bids is that, unlike Energy bids, Adjustment Bids reflect the willingness of both buyers and sellers to purchase transmission capacity. This creates a situation where any attempt to impose a soft cap on Adjustment Bids may cause purchasers of transmission to pay prices in excess of their bid price. In the Imbalance Energy market, any supply costs incurred for bids above the soft cap can ultimately be allocated to other Market Participants with negative uninstructed deviations through uplift charges that can be added to the Market Clearing Price. Market Participants incur uplift charges for Energy purchases above the soft cap due to the fact that they incurred negative uninstructed deviations, rather than the fact that they bid to purchase uninstructed Energy at the Market Clearing Price. In contrast, if any Congestion uplift charges created due to Adjustment Bids in excess of a soft cap are imposed on buyers of transmission, these buyers may ultimately be assessed charges in excess of their bids to purchase transmission. Attachment B hereto contains a specific example of a scenario in which any attempt to impose a soft cap on Adjustment Bids may cause purchasers of transmission to pay in excess of their bid price.

3. The Method of Cost Justification Would Need to Be Determined.

Any review of the cost justification of an Adjustment Bid in excess of a soft cap would may need to be based on the difference between the price of that Adjustment Bid and the price of other Adjustment Bids by the same Scheduling Coordinator that were dispatched. For example, a Scheduling Coordinator could have an Adjustment Bid of $600/MWh to increase supply on the congested side of a transmission path accepted in conjunction with an Adjustment Bid of $400/MWh to decrease supply on the opposite side of the transmission path, the result being a net price of $200/MWh. Alternatively, the Scheduling Coordinator could have an Adjustment Bid of $600/MWh to increase supply on the congested side of a transmission path accepted in conjunction with an Adjustment Bid of $0/MWh to decrease supply on the opposite side of the transmission path, the result being a net price of $600/MWh. However, because the pairs of Adjustment Bids that actually set Congestion prices are not specifically identified in the Congestion Management software, such a comparison of Adjustment Bids may be extremely difficult or even infeasible when Congestion on multiple transmission paths occurs and/or more than two Adjustment Bids within the Scheduling Coordinator's portfolio occurs. This could make it difficult even to identify Adjustment Bids that may be subject to cost justification and the basis for such justification.

4. A Disconnect Would Be Created Between Energy Schedules, Adjustment Bid Prices, and Congestion Charges and Payments.

The most significant issue the CAISO has identified is that implementing a soft cap on Adjustment Bids would create a disconnect between Energy schedules, Adjustment Bid prices, and Congestion charges and payments that would be extremely likely to create significant market inefficiencies, gaming opportunities, and inequities. The risk and uncertainties created by such a disconnect may also have the indirect effect of deterring scheduling and participation in the Adjustment Bid market. A further discussion of potential detrimental market impacts resulting from a disconnect and a simplified example illustrating one of the problems created by this disconnect are provided in Attachment B hereto.

5. Implementing a Soft Cap on Adjustment Bids Would Require a Significant Expenditure of the CAISO's Resources, Time, and Money, While the CAISO Is Working to Implement the New Market Redesign.

The CAISO's systems are not set up in such a way that would allow it to simply "plug in" a soft cap on Adjustment Bids. The CAISO would have to re-write its Congestion Management software or "CONG" in order to implement that change. As indicated in the Affidavit of Deborah A. Le Vine, Attachment A hereto, it would take the CAISO approximately six months *from the date that all* *design details are known (and such details are not known at this point)* to build, test, and integrate a new network model to accommodate a soft cap. A significant expenditure of CAISO resources, time, and money would be required to implement a soft cap on Adjustment Bids – at a time when the CAISO is working diligently to implement the new market redesign.

For all these reasons, the Commission should not require the CAISO to implement a soft cap on Adjustment Bids.

VI. MOTION FOR STAY

If the Commission does not grant the requested clarification and the Amendment No. 73 Order was intended to require a soft cap on Adjustment Bids, the CAISO requests that the Commission grant an immediate stay of the directive in the Amendment No. 73 Order to apply a soft cap to Adjustment Bids. The Commission may stay its action "when justice so requires." 5 U.S.C. § 705. In deciding whether a stay would be appropriate in a particular case, the Commission generally considers several factors: (1) whether the moving party will suffer irreparable injury without a stay; (2) whether issuing a stay will not substantially harm other parties; and (3) whether a stay is in the public interest.[9]

The present situation more than satisfies the standards for a stay. As explained in Section IV.C.5, above, the CAISO's systems are not set up in such a way as to allow it to employ a soft cap for Adjustment Bids. As explained in the

[9] *CMS Midland, Inc. v. Midland Cogeneration Venture Limited Partnership*, 56 FERC ¶ 61,177, at 61,631 (1991), *aff'd sub nom. Michigan Municipal Cooperative Group v. FERC*, 990 F.2d 1377 (D.C. Cir.), *cert. denied*, 510 U.S. 990 (1993). *See also, e.g., City of Tacoma*, 87 FERC ¶ 61,197 (1999).

attached Affidavit of Deborah A. Le Vine, the CAISO would have to expend significant resources, money, and time to change its software and systems to accommodate a soft cap for Adjustment Bids, at a time when it is working to implement MRTU. It would be a substantial burden on the CAISO to make such a commitment of resources, money, and time – especially since the CAISO would simultaneously be trying to implement MRTU – if the Commission ultimately will not require the CAISO to implement a soft cap. Thus, the CAISO will be irreparably harmed if the Commission does not grant a stay. Granting a stay is in the public interest for the same reasons and because of the policy reasons why the cap on Adjustment Bids should remain a hard cap, as explained in Section IV.C, above.

Also, issuing a stay will not result in substantial harm to other parties. In order to comply with the Amendment No. 73 Order to the greatest degree possible, the CAISO has implemented a soft $400/MWh cap for Energy bids and a hard $400/MWh cap for Adjustment Bids, as of the date the Amendment No. 73 Order was issued.[10] To date, no entity has submitted a bid over the $400/MWh cap for Adjustment Bids, and therefore no issues have arisen due to the CAISO's employing a hard cap for Adjustment Bids. (The CAISO cannot be sure, however, that in the future all Adjustment Bids submitted will remain at or below $400/MWh.) Further, as explained in Section III, above, the cap on Adjustment Bids has been a hard cap since it was first implemented, and Market Participants

[10] The market notice included in Attachment B to the instant filing states that the CAISO has implemented a soft cap of $400/MWh on Energy bids and a hard cap of $400/MWh on Adjustment Bids, effective as of the next applicable Trade Day following January 13, 2006 (the date the Amendment No. 73 Order was issued).

have always understood and been subject to that hard cap. As noted in the Affidavit of Deborah A. Le Vine (Attachment A hereto), no Market Participant has been seeking to change the hard cap on Adjustment Bids to a soft cap.

Accordingly, the CAISO requests that the Commission permit the CAISO to continue to use a hard cap for Adjustment Bids until either: (i) the Commission issues an order stating that the CAISO does not need to use a soft cap for Adjustment Bids, or (ii) the Commission issues an order stating that the CAISO needs to use a soft cap for Adjustment Bids, all complexities associated with implementing such a soft cap have been resolved, and the CAISO's systems have been modified so as to allow the CAISO to employ a soft cap for Adjustment Bids.

VII. CONCLUSION

Wherefore, for the reasons presented above, the CAISO respectfully requests that the Commission: (i) clarify that the Commission did not intend to direct the CAISO to change the long-standing hard cap on Adjustment Bids to a soft cap, or, (ii) in the alternative, if the Commission intended to require the CAISO to change the existing hard cap on Adjustment Bids to a soft cap, the Commission should: (a) grant rehearing on that issue for the reasons described above, and (b) grant a stay of the directive to allow the CAISO to retain a hard cap on Adjustment Bids.

Respectfully submitted,

_/s/ Kenneth G. Jaffe_____

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Dated: January 24, 2006

ATTACHMENT A

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	Docket Nos. ER06-354-___ and EL06-44-___

AFFIDAVIT OF
DEBORAH A. LE VINE

I, Deborah A. Le Vine, declare as follows:

1. My name is Deborah A. Le Vine and I am the Director of Market Services for the California Independent System Operator (“CAISO”). My business address is 151 Blue Ravine Road, Folsom, California 95630. As the Director of Market Services I am responsible for the "bid-to-bill" process of the CAISO's markets. This means that I oversee the groups responsible for market operations, market quality, market information, billing, settlements and settlements projects.

2. I received a Bachelor of Science degree in Electrical Engineering from San Diego State University in San Diego, California in May 1981. In May 1987, I received a Master in Business Administration from Pepperdine University in Malibu, California. In December 2002, I completed an Executive Program in Driving Government Performance: Leadership Strategies that Produce Results from the John F. Kennedy School of Government, Harvard University in Cambridge, Massachusetts. Additionally, I am a registered Professional Electrical Engineer in the State of California.

3. The purpose of my affidavit is to describe how the CAISO's market systems treat Adjustment Bids for Congestion Management, to explain that the CAISO has not investigated the implications of implementing a "soft" cap on Adjustment Bids and to discuss the steps that would be necessary to modify the CAISO’s market systems to implement such a "soft" cap on Adjustment Bids. In my affidavit, I will be using terms defined in the Master Definitions Supplement, Appendix A of the CAISO Tariff.

4. An Adjustment Bid is an offer by a Scheduling Coordinator to move its Generating Unit either up or down the bid curve at a given cost for each

segment from its preferred MW operating point to relieve Congestion on one side of a transmission constraint or the other.

5. In accordance with Section 7.2.4.2.1 of the CAISO Tariff, each Scheduling Coordinator is required to submit a preferred operating point for each of its resources. In accordance with Section 7.2.4.2.4 of the CAISO Tariff, a Scheduling Coordinator can revise its Adjustment Bids after the Day-Ahead Market has closed, for consideration in the Hour-Ahead Market and, after the Hour-Ahead Market has closed, for consideration in the Real Time Market.

6. The CAISO uses Adjustment Bids in each of its markets to manage Congestion. In the Day-Ahead and Hour-Ahead Markets, the CAISO manages Congestion between its 37 Zones (3 internal and 34 external), which is considered to be Inter-Zonal Congestion. In the Real Time Market, the CAISO manages Congestion within the three internal Zones, or Intra-Zonal Congestion.

7. To date, the CAISO has always treated Adjustment Bids as a firm value limited by a "hard" bid cap. The CAISO has never implemented a soft cap on Adjustment Bids.

8. The CAISO has not investigated all of the questions, potential implications and complexities associated with changing the hard cap on Adjustment Bids to a soft cap. Such a change could have unintended consequences that the CAISO has not yet considered. Having a soft cap on Adjustment Bids could result in unanticipated detrimental market impacts, inefficient results, and potential gaming opportunities. For example, Adjustment Bids can be used to trigger counterflow schedules that get paid for Congestion relief by, in effect, creating more transmission capacity in the other (congested) direction. Counterflows result when Scheduling Coordinators have schedules in the opposite direction of Congestion.

9. As discussed in Attachment B to this filing, a soft cap on Adjustment Bids prompts a number of questions including 1) if a Scheduling Coordinator ("SC") schedules above the cap, what number is used to solve for Congestion in the specific market? 2) if a number other than the bid is used to solve Congestion, what happens to the amount above the cap? i) is it eventually charged to the SCs whose schedule was allowed to transit the grid? ii) is it charged to all schedules on the congested path? iii) is it charged to all metered Demand and exports on both sides of the Congestion? or iv) something else? Another question is Commission review of these caps. To date the Commission has not reviewed Adjustment Bids caps. What schedule and process would the Commission use for this review?

10. The CAISO would need to know the answer to these questions, and probably others once more detail is known, before it could implement a soft cap for Adjustment Bids. It is likely that other implementation issues would also need to be resolved before the CAISO could implement such a cap.

11. Implementing a soft cap on Adjustment Bids also would take a substantial amount of time, and effort, including significant modifications to the CAISO's software systems. I believe that once all of the design details are known and *all* of the implementation issues are resolved, the CAISO could build, test and integrate a new network model to implement a soft cap on Adjustment Bids in approximately six (6) months.

12. However, I would not recommend such a change to a hard cap on Adjustment Bids at this time. Because the CAISO is focused on redesigning the majority of its software systems to implement the CAISO's Market Redesign and Technology Upgrade ("MRTU"), including testing, integration and market simulation, and because I am not aware of Market Participants clamoring for this

feature, I would recommend that if the CAISO were to implement a soft cap for Adjustment Bids it should do so no earlier than release 2 of MRTU which is anticipated in 2008.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

Executed on January 24, 2006.

Deborah A. Le Vine

Deborah A. Le Vine

State of California
County of Sacramento

Subscribed and sworn before me on this 24 day of January, 2006

Cayden Jenness

Notary Public

My Commission Expires: 2-9-09

CAYDEN JENNESS
Commission # 1543721
Notary Public - California
Sacramento County
My Comm. Expires Feb 9, 2009

ATTACHMENT B

This attachment illustrates one way in which a soft cap on Adjustment Bids may create inequitable and inefficient results in the CAISO's markets.

The principle of a soft cap is that bids may be accepted (and ultimately paid) at prices over the soft cap, but that any bids over the soft cap do not set the Market Clearing Price. However, applying the concept of a soft cap to Adjustment Bids is highly problematic, largely because Adjustment Bids are not actually accepted individually, and Congestion prices are not set by individual Adjustment Bids. Rather, Adjustment Bids must be accepted in combination with one or more other Adjustment Bids submitted by the same Scheduling Coordinator (SC), with Congestion prices being set based on the maximum difference between the prices of different Adjustment bids that are “marginal” or partially accepted as part of the Congestion Management software. Thus, attempting to apply a soft cap to Adjustment Bids might require multiple runs of the Congestion Management software in order to calculate Congestion prices that would result if an Adjustment Bid in excess of the $400/MWh soft cap were not allowed to set the Congestion prices.

Specific rules for calculating Congestion prices without Adjustment Bids in excess of the $400 soft cap would need to be developed if the CAISO were to implement a soft cap for Adjustment bids. However, this example assumes that the CAISO sought to implement the concept of a soft cap for Adjustment Bids as follows:

- The Congestion Management software would first resolve Congestion using all Adjustment Bids. Actual final schedules of participants would be based on results of this run of the Congestion Management software.

- A special pricing run of the Congestion Management software would then be performed to determine Congestion market prices paid or received by participants for all schedules except those involving Adjustment Bids over the soft cap. This pricing run would be made based only on those schedules accepted as part of the initial run Congestion Management software.[1] However, prior the making this pricing run, any Adjustment Bids prices in excess of the soft cap would be reset at the soft cap. Thus, prices resulting from this special pricing run would not be set by Adjustment Bids in excess of the soft cap.[2]

[1] In practice, schedules and Adjustment Bid quantities would need to be “fixed” or constrained within a small deviation from final results of the initial run in order to allow the pricing run to be solved, while maintaining the scheduled quantities resulting form the initial run of the Congestion model.

[2] Another option could be to base the Congestion price on the Adjustment Bids of the SC with the next lowest price spread that would have set the price if the SC with an Adjustment Bid in excess of the soft cap were not accepted. However, this approach would allow prices to be set based on schedules that were not actually accepted the Congestion Management process, and would therefore crate an even greater disconnection between market prices and actual schedules.

Given the process for implementing a soft cap described above, this example is based on the following scenario:

- One Scheduling Coordinator (hereafter referred to as "SC1") submits wheeling schedules with Adjustment Bids indicating a preference to wheel power from the Pacific Northwest through the CAISO Control Area to the Southwest if Congestion charges do not exceed $100/MWh in the CAISO's Day-Ahead Congestion Management market.[3] SC1's bids are accepted due to the Congestion patterns and prices illustrated in Figure 1, below.

- A second Scheduling Coordinator (hereafter referred to as "SC2") submits Adjustment Bids indicating a willingness to reserve transmission into the CAISO's northern Congestion Zone (NP15) from the Northwest at a cost of up to $300/MWh in the CAISO's Day-Ahead Congestion Management market. SC2's bids are partially accepted and set the Congestion price for imports on this import path, as indicated by the $300 price shown for imports into NP15 in Figure 1.

- A third Scheduling Coordinator (hereafter referred to as "SC3") submits Adjustment Bids indicating a willingness to reserve transmission from NP15 into the CAISO's southern Congestion Zone (SP15) at a cost of up to $300/MWh in the CAISO's Day-Ahead Congestion Management market.[4] SC3's bids are partially accepted and set the Congestion price, as indicated by the $300 Congestion price shown for north to south flows between NP15 and SP15 on in Figure 1.

- A fourth Scheduling Coordinator (hereafter referred to as "SC4") submits Adjustment Bids indicating a willingness to reserve transmission into SP15 from the Southwest at a cost of up to $500/MWh in the CAISO's Day-Ahead Congestion Management market. One of SC4's Adjustment Bids exceeds the $400/MWh cap, but is still accepted by the CAISO's Congestion Management software due to a soft cap on Adjustment Bids.[5] However, since one of SC4's

[3] In practice, SC1 could indicate a willingness to pay up to $100 for transmission using a virtually unlimited combination of Adjustment bid prices. However, for the sake of illustration, it may be assumed that SC1 submitted an import wheeling schedule into the CAISO from the Northwest with an Adjustment Bid indicating a willingness to decrement this schedule at a Adjustment Bid price of $200, combined with an export wheeling schedule from the CAISO to the Southwest with an Adjustment Bid indicating a willingness to decrease this export schedule at a Adjustment Bid price of $300. The $100 difference in these two Adjustment Bids ($300 - $200) represents the price spread used in the Congestion Management to determine if these Adjustment Bids were exercised.

[4] In this example, it is assumed that north-to-south Congestion occurs on Path 26, but no Congestion occurs on Path 15, so that the CAISO central Congestion Zone (ZP26) is effectively part of NP15.

[5] For example, assume that SC4 submitted an Adjustment Bid on an import schedule into the CASIO from the Southwest indicating a willingness to decrement this schedule at a price of $0,

Adjustment Bids exceed the $400/MWh soft cap, SC4's initial Adjustment Bids are not allowed to set the final price in the CAISO's Day-Ahead Congestion Management market. As a result, the final Congestion market price for flows on this transmission path is only $400/MWh.[6]

The scenario described above creates a situation where, after adjustment of market prices to reflect the $400/MWh soft cap on Adjustment Bids, SC1 would incur net Congestion charges of $200/MWh, although SC1 had submitted Adjustment Bids indicating a willingness to wheel Energy through the CAISO at a price of up to only $100/MWh. As shown in the table provided below Figure 1, the increase in net Congestion charges for SC1 results from the reduction in credit received by SC1 for the counterflow scheduled in the export direction from the CAISO to the Southwest that is created when the Congestion price from imports on this transmission path is reduced from $500/MWh to $400/MWh.

The inequitable result illustrated in Figure 1 might be addressed through a set of settlement rules designed to ensure that no Scheduling Coordinator is charged in excess of its willingness to pay as expressed in its Adjustment Bid prices, while no Scheduling Coordinator is paid for counterflows that are less than the price level expressed in its Adjustment Bid prices. However, given the nature of Adjustment Bids, any such a set of rules would be extremely complicated, and it may be infeasible to develop a set of rules that addressed all possible scenarios involving Congestion on multiple paths and more than two Adjustment Bids.

In addition to creating an inequitable market outcome for SC1, the scenario described above could lead to inefficient market outcomes as Scheduling Coordinators seek to protect themselves from such outcomes by adjusting their bidding patterns. For example, to the extent that Scheduling Coordinators modified their Adjustment Bids or reduced scheduling to protect against the potential scenario described above, economically efficient adjustments in schedules and supply resources may be reduced.

Other variations of this scenario are also likely to create a variety of gaming opportunities through which a Scheduling Coordinator might take advantage of market rules to the detriment of other Market Participants, overall market

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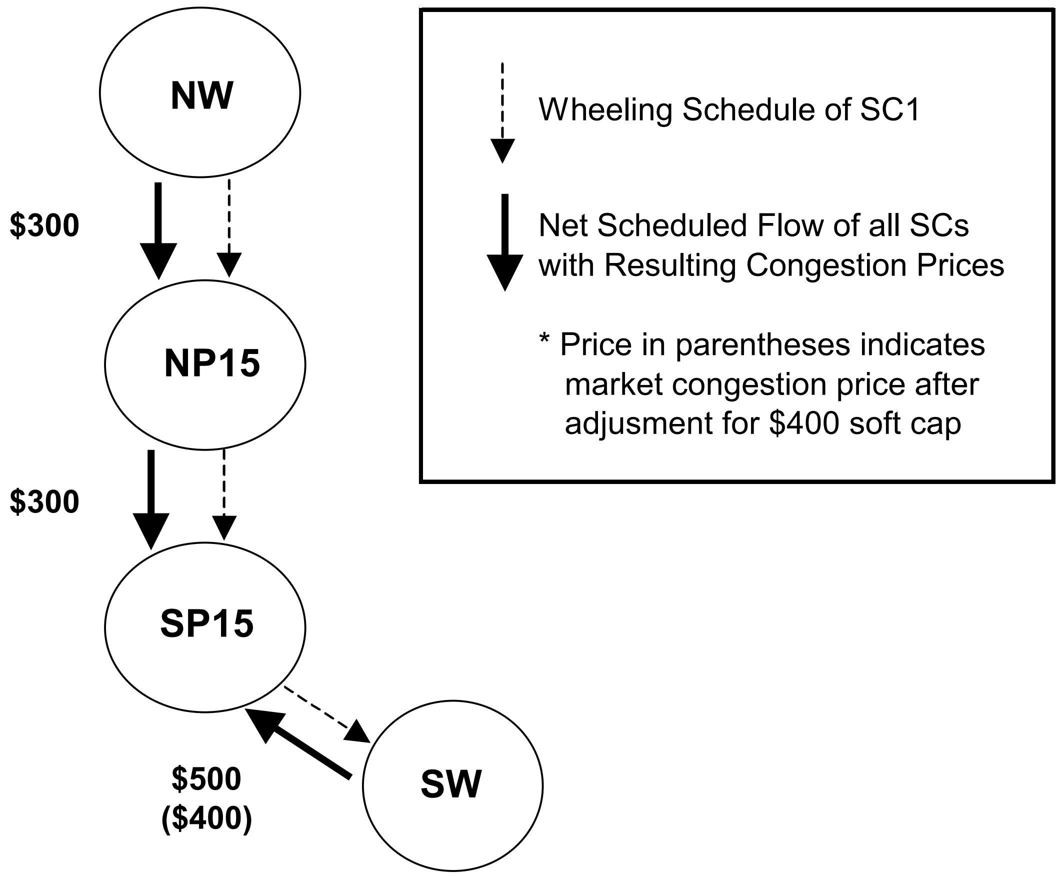
and a separate Adjustment Bid to increase an import schedule on another Branch Group at a price of $500. The $500 difference in these two Adjustment Bids represents the price spread used in the Congestion Management to determine if these Adjustment Bids were exercised and, if so, what the Congestion price might be set by these Adjustment Bids if SC4's import schedule is the "marginal" schedule that is partially curtailed in the Day-Ahead Congestion Management market.

[6] Specifically, under the process for implementing the soft cap described on page 1 of this attachment, the $500 Adjustment Bid submitted by SC4 described in Footnote 6 would be reset to $400, so that the spread between SC4's Adjustment Bids was reduced to $400. Thus, SC4's Adjustment Bids would still set the Congestion price, but would set a price of only $400.

efficiency, and even system reliability. Experience indicates that such gaming opportunities are frequently created and exploited whenever a disconnection is created between prices paid and received by buyers and sellers is created. For example, in the context of the Congestion Management market, the opportunity to get paid for a counterflow schedule at a bid price above the $400/MWh soft cap, while paying Congestion charges for other schedules at a capped of $400/MWh, may create the ability to schedule and bid in a manner that entails a net gain without providing any actual net energy on a transmission path.

Figure 1



Wheeling Schedule Flow	Congestion Charge (Payment)* Before Soft Cap Adjustment	After Soft Cap Adjustment
NW → NP15	$300	$300
NP15 → SP15	$300	$300
SP15 → SW	($500)*	($400)*
Total Charge (SC1)	$100	$200

* Payments (or reduction in overall Congestion charges) result when Scheduling Coordinators have schedules in the opposite direction of Congestion (or “counterflows”). Such counterflow payments (or credits) are made based on the Congestion price for the transmission Congestion path.

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California this 24^{th} day of January, 2006.

/s/ Anthony J. Ivancovich
Anthony J. Ivancovich