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January 5, 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 No. ER06-354-000**

Dear Secretary Salas:

Attached please find the Motion for Leave to File Answer and Answer to Protests, and Answer to Motions to Intervene and Comments, of the California Independent System Operator Corporation, submitted in the above-captioned docket.

Thank you for your assistance 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) Docket No. ER06-354-000
Operator Corporation)**

**MOTION FOR LEAVE TO FILE ANSWER AND ANSWER TO PROTESTS,
AND ANSWER TO MOTIONS TO INTERVENE AND COMMENTS, OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

On December 21, 2005, the California Independent System Operator Corporation (“CAISO”)¹ submitted Amendment No. 73 to the CAISO Tariff (“Amendment No. 73”) in the captioned proceeding. In Amendment No. 73, the CAISO proposed to revise its Tariff to change the current “soft” \$250/MWh Damage Control Bid Cap (“bid cap”) for real-time Energy bids and Adjustment Bids to a “hard” \$400/MWh bid cap. The CAISO requested that the Commission issue an order on Amendment No. 73 on an expedited basis in accordance with the Commission's *Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,009 (2005), and requested that Amendment No. 73 be permitted to go into effect as of January 1, 2006 or as soon thereafter as possible.

The Commission established a January 3, 2006, comment date for Amendment No. 73, and in response a number of parties submitted motions to

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

intervene.² In addition, AReM, the CEOB, IEP, the Indicated Parties, PGE, Powerex, and Williams submitted comments, and PNM and Santa Clara submitted protests.

The CAISO does not oppose any of the motions to intervene submitted in this proceeding. However, pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the CAISO files its answer to the comments that seek significant modifications to Amendment No. 73, and pursuant to Rules 212 and 213 of the Commission's Rules, 18 C.F.R. §§ 385.212, 385.213, the CAISO respectfully requests leave to file an answer, and files its answer to the protests of Amendment No. 73.³ As explained below, the Commission should accept Amendment No. 73 as filed.

² Motions to intervene were submitted by: the Alliance for Retail Energy Markets ("AReM"); Avista Energy, Inc., Puget Sound Energy, Inc., Coral Power, L.L.C., and Sempra Energy (together, the "Indicated Parties"); the California Department of Water Resources State Water Project; the California Electricity Oversight Board ("CEOB"); the City of Santa Clara, California ("Santa Clara"); the Modesto Irrigation District; Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC, and Mirant Potrero, LLC; Northern California Power Agency; Pacific Gas and Electric Company ("PG&E"); Portland General Electric Company ("PGE"); Powerex Corp. ("Powerex"); Public Service Company of New Mexico ("PNM"); the Sacramento Municipal Utility District; Southern California Edison Company; Williams Power Company, Inc. ("Williams"). The Independent Energy Producers Association ("IEP") submitted a motion for leave to intervene out-of-time.

³ 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. 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. 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 Company*, 93 FERC ¶ 61,098, at 61,259 (2000).

I. STATEMENT OF ISSUES

In accordance with Rule 203(a)(7), 18 C.F.R. § 385.203(a)(7), the CAISO provides this Statement of Issues.

1. The Commission should reject as groundless the intervenors' hypothetical concerns about a "hard" bid cap, and should approve the use of a hard bid cap in this proceeding consistent with the Commission's directives to use a hard bid cap under the new California market design.
2. Santa Clara erroneously contends that Amendment No. 73 has already gone into effect. Further, Santa Clara is incorrect in arguing that the CAISO is prohibited from implementing Amendment No. 73 as of a date prior to the date that the Commission issues an order on the amendment.
3. The Commission should reject the proposal of Powerex that the Commission increase to \$400/MWh the current soft bid cap of \$250/MWh that applies to capacity bids submitted in the CAISO's Ancillary Services markets. There is no reason to increase the Ancillary Services bid cap or to believe that different bid caps for Energy and Ancillary Services could distort electricity markets.
4. The CAISO would not be opposed to an increase of the bid cap on energy that currently applies to sales in the parts of the West outside of California.

II. ANSWER

A. **The Commission Should Approve the Use of a Hard Bid Cap in this Proceeding Consistent with the Commission's Directives to Move to a Hard Bid Cap Under the New California Market Design**

Many intervenors, including the California Electricity Oversight Board, support Amendment No. 73 as filed. See CEOB at 3-5; AReM at 3-4.⁴ In addition, no intervenor opposes the CAISO's proposal to increase the bid cap for real-time Energy bids and Adjustment Bids from \$250/MWh to \$400/MWh. Several intervenors, however, argue that the increased \$400/MWh bid cap should be a "soft" bid cap, and that the CAISO should not move to a "hard" bid cap. IEP at 3; PGE at 3-4; PNM at 3-7; Santa Clara at 7-9; Williams at 4-7. These intervenors fail to provide evidence, however, showing that a hard \$400/MWh bid cap will create difficulties for the California markets or will otherwise result in unjust and unreasonable rates. Instead, the intervenors' arguments are based on their own hypothetical concerns about the use of any hard bid cap – no matter what the dollar level of that cap. Those concerns are not shared by the Commission. In its July 1, 2005, order on proposed market design elements for inclusion in the CAISO's Market Redesign & Technology Upgrade ("MRTU"), the Commission expressed its disagreement with the CAISO's proposal to retain a soft bid cap of \$250/MWh on day one of MRTU implementation. The Commission instead directed the CAISO to employ a hard

⁴ See also PG&E at 3 (stating that PG&E "generally supports Amendment No. 73," though PG&E "reserves comment as to the specific changes to the CAISO Tariff proposed by Amendment No. 73").

\$500/MWh bid cap on day one of MRTU implementation. The Commission stated that:

gas prices could rise to a level that would justify competitive prices above \$250/MWh. Rather than suppressing the market clearing price by regulatory fiat, it would be more appropriate to allow all competitive bids to clear supply and demand and send transparent price signals to encourage demand response, market entry and forward contracting. In addition, allowing the CAISO to procure out-of-market energy at prices that exceed the soft cap may provide unintended incentives for sellers to refrain from bidding into the CAISO market in order to receive higher out-of-market payments. Accordingly, the initial bid cap should be a hard cap set at \$500/MWh.

California Independent System Operator Corp., 112 FERC ¶ 61,013, at P 104 (2005) (“July 1 Order”). Thus, the Commission found the benefits of a hard bid cap to outweigh any potential risks such a cap might present.

One of the reasons the Commission provided in the July 1 Order for directing the use of a hard bid cap at a level higher than the current soft bid cap was that allowing the CAISO to procure out-of-market energy at prices that exceed the current soft bid cap may provide incentives for sellers to refrain from bidding into the CAISO market. The Commission’s rationale in the July 1 Order undercuts PGE’s argument in this proceeding that the CAISO should use a soft bid cap because even an increased hard bid cap could force the CAISO to resort to out-of-market purchases when there are insufficient bids at or below the cap to meet system demand. See PGE at 3. The CAISO expects that the increased \$400/MWh hard bid cap will be high enough that it should not need to resort to out-of-market purchases that are above the cap. To the extent that PGE’s hypothetical concern were to become a reality (e.g., if the CAISO were required

to rely on out-of-market purchases above the \$400/MWh hard bid cap on an ongoing basis), the CAISO would be willing to revisit the issue of the level of the hard bid cap.

B. Contrary to the Assertions of Santa Clara, the CAISO Has Not Yet Implemented Amendment No. 73

Santa Clara argues that the CAISO has already implemented the CAISO Tariff changes contained in Amendment No. 73 in violation of the Federal Power Act (“FPA”) and the Commission’s procedures. Santa Clara at 6-7.

Santa Clara is mistaken when it states that Amendment No. 73 has already gone into effect. The CAISO has not implemented Amendment 73. Indeed, the CAISO made repeated statements in the transmittal letter for Amendment No. 73 and in the CAISO market notice included in Attachment A to Santa Clara’s filing that the CAISO has requested that the amendment be made effective on January 1, 2006 *or as soon thereafter as possible*. The CAISO intends to make the \$400/MWh hard bid cap requested in Amendment No. 73 effective on the day after the Commission issues an order on Amendment No. 73.

Further, Santa Clara’s legal arguments are incorrect. The CAISO is permitted under Section 205 of the FPA to request waiver of the 60-day prior notice requirement.⁵ In the case of Amendment No. 73, the CAISO requested an effective date of no sooner than January 1, 2006 – eleven days after the date the CAISO filed Amendment No. 73. Moreover, the Commission has the legal authority to grant a waiver of the 60-day prior notice requirement even if the order

⁵ See *Central Hudson Gas & Electric Corp., et al.*, 60 FERC ¶ 61,106, *reh’g denied*, 61 FERC ¶ 61,089 (1992).

granting the waiver is issued after the requested effective date. For example, the Commission issued an order on November 21, 2005, granting a September 23, 2005, effective date for Amendment No. 72 to the CAISO Tariff. *California Independent System Operator Corp.*, 113 FERC ¶ 61,187 (2005).

C. The Commission Should Reject Powerex's Proposal that the Commission Also Raise The Bid Cap For Capacity In the Ancillary Services Markets To \$400/MWh

Powerex requests that the Commission increase the bid cap for capacity bids submitted in the CAISO's Ancillary Services markets from the current soft bid cap of \$250/MWh to \$400/MWh. Powerex at 6. The Commission should reject that proposal.⁶

The main justification for increasing the cap on real-time Energy bids and Adjustment Bids, as proposed in Amendment No. 73, is that substantially higher natural gas prices may result in the CAISO being unable to attract sufficient supply bids to maintain system reliability. Amendment No. 73 Transmittal Letter at 7. In that regard, the cost of gas supplies is a component of the variable costs incurred to produce energy. That rationale does not apply to the Ancillary Services capacity bid cap because no variable costs are incurred to make Ancillary Services capacity available. Ancillary Services capacity is a fixed cost. Thus, an increase in natural gas prices does not affect the cost of Ancillary Services capacity. To the extent the CAISO accepts an Ancillary Services capacity bid from a supplier, and then calls on the unit to provide energy, the

⁶ Amendment No. 73 does not involve any proposed changes to Ancillary Services pricing or bidding. If Powerex believes that changes to Ancillary Services pricing or bidding are appropriate, it should seek to raise the issue via a filing with the Commission pursuant to Section 206 of the FPA, not via comments in a Section 205 proceeding where no changes to Ancillary Services pricing or bidding are proposed.

supplier will be able to reflect any increased gas costs in its energy bid. In any event, the CAISO notes that the \$250/MWh cap on Ancillary Services capacity bids will continue to be a soft bid cap, so Market Participants will still have the opportunity to submit Ancillary Service capacity bids in excess of \$250/MWh, provided they can provide cost justification for such bids.

Powerex also argues that different bid caps for Energy and Ancillary Services could distort electricity markets. Powerex at 6. The claim that Energy and Ancillary Service markets must have the same bid caps in order to prevent market distortions is unsustainable. In the East, the caps on Energy bids are often much higher than the caps on ancillary service bids. For example, PJM has a \$1,000/MWh energy bid cap and a \$100/MWh regulation bid cap. See July 1 Order, 112 FERC ¶ 61,013 at P 109. Moreover, in the order directing the CAISO to move to a hard cap on Energy bids of \$500/MWh on day one of MRTU implementation, the Commission also directed the CAISO to retain the \$250/MWh cap on Ancillary Services. *Id.* at P 111. Consistent with that decision, the Commission should keep the Ancillary Services bid cap at \$250/MWh and reject the proposal to raise it to \$400/MWh.

D. The CAISO Would Not Oppose an Increase of the Bid Cap that Applies in the Parts of the West Outside of California

The Indicated Parties and Powerex assert that the Commission should increase the bid cap that applies in the West outside of California to a dollar level equal to that proposed in Amendment No. 73 (though they argue that the outside-California cap should be a soft bid cap rather than a hard bid cap). Indicated Parties at 5-7; Powerex at 5-6. The CAISO would not oppose an

increase to the energy bid cap currently applicable to sales in Western Electricity Coordinating Council (“WECC”) spot markets.

III. CONCLUSION

For the reasons explained above, the Commission should accept Amendment No. 73 as filed.

Respectfully submitted,

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Counsel for the California Independent
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Dated: January 5, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California, on this 5th day of January, 2006.

Sidney Mannheim Davies
Sidney Mannheim Davies