UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	Docket No. ER07-648-000

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

I. INTRODUCTION

On March 22, 2007, the California Independent System Operator Corporation ("CAISO") submitted to the Commission an amendment to the ISO Tariff that revises the method for assigning transmission import capability into the ISO Control Area to Load Serving Entities ("LSEs") for resource adequacy reporting and compliance purposes ("Amendments"). Motions to Intervene were due on April 12, 2007.[1] Comments on the Amendments were generally supportive; however, several parties raised narrow concerns or submitted limited protests.[2]

The concerns of commenting parties focused on: (1) the ability of LSEs to bilaterally trade assigned import capability and (2) the method for assigning import capability in the event a particular branch group is over-requested. The CPUC also offered several other suggestions to enhance the clarity of the Amendments and better

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[1] Motions to Intervene without substantive comments were filed by: the California Electricity Oversight Board, Williams Power Company, Modesto Irrigation District, the Sacramento Municipal Utility District, Western Area Power Administration, Powerex Corp., and Constellation Energy Group Companies.

[2] Motions to Intervene with substantive comments or protests were filed by the City of Santa Clara ("SVP"), the California Municipal Utilities Association ("CMUA"), the Northern California Power Agency ("NCPA") the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside (collectively "Six Cities"), the Alliance for Retail Energy Markets ("AReM"), and the California Public Utilities Commission ("CPUC"). Pacific Gas and Electric Company and Southern California Edison Company also filed comments in support of the Amendments that indicated a need for future evaluation of means to better

ensure consistency between the tariff provisions and the CPUC's resource adequacy program. As explained below, the Commission should accept the Amendment as filed, subject only to the modifications identified in this answer.

II. MOTION FOR LEAVE TO ANSWER PROTESTS

There is no prohibition on an answer to comments. Answers to protests are not usually permitted under Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2). The CAISO therefore requests waiver of the rule to permit it to file this Answer. Good cause for a waiver exists because this 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.[3]

III. ANSWER

A. Permitting Bilateral Secondary Trades of Import Capability Is Consistent with Commission Precedent

Several public power entities, including the Six Cities, CMUA, and NCPA, object to the aspect of the Amendment that allows LSEs to sell allocated import capability in a secondary, decentralized bilateral market on whatever terms can be negotiated. Those entities argue that the failure to establish specified conditions for the release of unneeded import capability back to the CAISO for reassignment to other LSEs that need the import capability will result in the unjust, unreasonable, and unduly discriminatory exercise of market power by large LSEs.[4] The CAISO believes these concerns are misplaced. First,

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support longer-term resource adequacy commitments by LSEs.

[3] *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); and *Delmarva Power & Light Company*, 93 FERC ¶ 61,098 at 61,259 (2000).

[4] *See, e.g.*, Six Cities Comments at 5.

the CAISO believes that the reasonableness of its initial allocation methodology ensures an appropriate disposition of the import capacity for resource adequacy purposes. Thus, the first protection against the exercise of market power is not the secondary market but the initial allocation.

Second, the CAISO believes that its position with respect to the secondary market best assures that any excess import capacity will be utilized and that the Commission's recent decision in Order No. 890[5] to lift the price cap for the reassignment of transmission capacity supports the CAISO's approach.

In Order No. 890, the Commission determined that to foster the development of a more robust secondary market for the reassignment of transmission capacity, it was appropriate to remove the existing price cap. The removal of the price cap was viewed as essential to "allow capacity to be allocated to those entities that value it the most…."[6] Nor was the price cap viewed as necessary to ensure just and reasonable rates given three factors: (1) the continued regulation of rates for primary transmission capacity, (2) reporting reforms, combined with enforcement proceedings, audits and other regulatory controls, and (3) competition among reassigning customers.[7]

Order No. 890 emphasized that the only adopted reform related to the resale of transmission capacity by transmission customers, not the sale of primary transmission capacity by the transmission provider. Customers in need of transmission capacity could continue to obtain such available capacity under regulated rates. Here, LSEs are

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5 *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 FR 12266 (March 15, 2007), FERC Stats. & Regs. ¶ 31,241 (2007), *reh'g pending* ("Order No. 890").

6 Order 890 at P 808.

7 Order 890 at P 809-811.

similarly allocated, without cost, their appropriate share of import capability based on a regulated, Commission-approved process. Only in those circumstances where an LSE voluntarily desires to increase its proportionate share of imports to meet resource adequacy requirements may it be necessary for that LSE to transact in the secondary market. This is fundamentally different than the market for primary transmission capacity, which may not be available and thereby forces transmission customers into the secondary market.

Even where primary transmission capacity was unavailable, the Commission found that competition among sellers would mitigate the ability to exercise market power in the secondary transmission capacity market. The allocation process will lead to a significant number of LSEs holding import capability that could be available in the secondary market. The existence of this number of potential sellers will operate to offset, to some degree, the admitted concentration of import capability in the two largest investor-owned utilities. Nevertheless, the CAISO recognizes that, unlike the secondary market for transmission capacity, the Commission cannot rely on its experience with bilateral transactions in California for resource adequacy related import capability.

For that reason, the CAISO includes provisions in its tariff that enhance the regulatory oversight of the secondary market for import capability. For instance, import capability transactions, including price, are to be communicated by affected Scheduling Coordinators to the CAISO for quarterly transmittal to the Commission. The quarterly reports will assist the Commission in gathering data to ensure the effectiveness of market forces and regulatory requirements to mitigate any exercise of market power. The transaction data as well as the CAISO's visibility regarding a LSE's use of its allocated

import capability should provide the Commission with the means to oversee the secondary market and determine whether future changes may be necessary.

The CAISO notes that under the MRTU market design, the CAISO will not limit CRR ownership concentration levels and restrict purchases in the secondary market. The Commission approved the proposal to require "all market participants register changes in CRR holdings through the CAISO's secondary registration system."[8] The instant proposal with regard to transactions in the secondary market for allocations of import capacity for resource adequacy purposes is consistent with this approach and should be accepted.

B. The Commission Should Reject NCPA and SVP's Alternative "Tie-Breaker" Methodology and Approve the CAISO's Load Ratio Share Methodology

NCPA and SVP suggest that the "problem of an oversubscribed branch group be handled by allocating to all LSEs requesting at the branch group a pro rata share of the import capability based on their requests," rather than the CAISO's proposed methodology, which is based on LSEs' pro rata share of coincident peak system load.[9] According to NCPA and SVP, the CAISO's methodology will disproportionately harm smaller LSEs with little coincident peak load share because contracting for small megawatt quantities purportedly may not be commercially viable. The CAISO's interest, like that of NCPA and SVP, is to ensure the assignment of import capability is equitable, and the CAISO believes its coincident peak load share ratio methodology meets this objective.

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8 *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 (2006) at P 871, *Order on Rehearing*, 119 FERC ¶ 61,076 (2007).

NCPA and SVP's recommendation must be put in proper context. Under Step 4 of the proposed allocation methodology, the Pre-RA Import Commitments of smaller LSEs will be provided a priority in the assignment of import capability and therefore will likely be honored. The CAISO noted in its transmittal letter that "[b]ecause, by definition, virtually all Pre-RA Import Commitments participated in the IRRP assignment process for 2007 RA Compliance Year and were accommodated, the CAISO does not anticipate that a branch group will be over-requested during this step in the assignment process."[10] The result is that those smaller LSEs that have historically relied heavily on imports can continue to do so to satisfy their resource adequacy obligations.

Accordingly, the relevant consideration pertains to how Remaining Import Capability should be assigned to LSEs to account for future resource adequacy transactions. In this regard, if a branch group is over-requested based on Remaining Import Capability, it indicates that several LSEs view that branch group as valuable. Without an auction, there is no way to determine the relative value placed on the branch group by the competing LSEs. As such, the CAISO believes that the most equitable method, subject to the least potential gaming, is to assign the available capacity in proportion to the relative size of the LSEs, which corresponds to need as well as contribution to the cost of the transmission grid. For these reasons, the CAISO submits that its proposed method of breaking ties on over-requested branch groups is just and reasonable.

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9 NCPA Comments at 5.

10 CAISO Transmittal Letter at 7.

C. Response to the CPUC

1. Language to Permit Flexibility on One-Year Term

The CPUC notes that a question in its pending resource adequacy proceeding is whether to shift the resource adequacy compliance year from January through December to May through April in order to better align the process with the load forecast procedures of the California Energy Commission.[11] Proposed Section 40.5.2.2.1 provides that import capacity … "will be assigned on an annual basis for a one-year term … ." The CPUC observes that the unqualified yearly term in Section 40.5.2.2.1 may ultimately conflict with the need for a longer, transitional or interim resource adequacy compliance cycle should to accommodate a potential shift in the CPUC's compliance cycle.

The CAISO concurs with the CPUC that "[c]oordination of the CPUC's [resource adequacy] program with the CAISO's tariff is essential to avoid creating undesirable market effects … . A lack of such coordination could impair LSE's ability to procure RA Capacity."[12] Cognizant of the need for coordination, the CAISO agrees that flexibility is needed to accommodate a potential one-time extension of the CPUC compliance period to account for the redefinition of the CPUC's compliance year. This modification should be narrowly tailored. Accordingly, the CAISO proposes the following:

> For Resource Adequacy Plans covering any period after December 31, 2007, total Available Import Capability will be assigned on an annual basis for a one-year term to Load Serving Entities serving Load in the ISO Control Area and other Market Participants through their respective Scheduling Coordinators, as described in the following sequence of steps.

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11 CPUC Comments at 5.

12 CPUC Comments at 4.

However, should the CPUC as part of CPUC proceeding R.05-12-013 modify by decision in 2007 its compliance period from January to December of the calendar year to May through April of the calendar year, the CAISO shall extend the effectiveness of the assignment for 2008 Compliance Year through April 2009.

2. Consistent with the Position of the CPUC, Step 8 Does Not Allow the Transfer of Existing Contract Import Capacity or Pre-RA Import Commitment Capacity

The CPUC suggests that the language in Section 40.5.2.2.1 is unclear whether LSEs are allowed to transfer Existing Contract Import Capability and Pre-RA Import Capability as part of Step 8.[13] Step 8 provides, in pertinent part, that "a Load Serving Entity shall be allowed to transfer some or all of its Remaining Import Capability to any other Load Serving Entity or Market Participant." The CAISO believes the absence of any reference in Step 8 to either Existing Contract Import Capability or Pre-RA Import Capability clearly excludes those types of import capability categories from the trading contemplated under that step. It follows from the definition of Remaining Import Capability[14] and the manner in which Remaining Import Capability is assigned in Step 5 without reference to any particular branch group that Remaining Import Capability is discrete from Existing Contract Import Capability or Pre-RA Import Capability.

The CPUC, however, notes that Section 40.5.2.2.2.1 seems to suggest that any type of import capability may be transferred under Step 8. That section provides that "[t]o be eligible to engage in any bilateral assignment, sale, or other transfer of Existing Contract Import Capability, Pre-RA Import Commitment Capability or Remaining Import Capability, whether pursuant to Step 8 of Section 40.5.2.2.1 or Section 40.5.2.2.2.2," an

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13 CPUC Comments at 5.

14 Remaining Import Capability is "[t]he quantity in MW of Total Import Capability assigned to a Load Serving Entity up to its Load Share Quantity after the assignment of Existing Contract Import Capability and Pre-RA Import Commitment Capability."

LSE must provide specific information. The intent of this language is to provide a general requirement that information be provided as a precondition to any transfer of any type of import capability under either of the two sections authorizing transfers. That said, if the Commission believes this general reference creates ambiguity regarding the specific provisions of Step 8, the CAISO proposes the following modification to be made as part of a future compliance filing:

> To be eligible to engage in any bilateral assignment, sale, or other transfer of Remaining Import Capability under Step 8 of Section 40.5.2.2.1 or of Existing Contract Import Capability, Pre-RA Import Commitment Capability or Remaining Import Capability~~, whether pursuant to Step 8 or~~ under Section 40.5.2.2.2.2, a Load Serving Entity ….

The more important question raised is whether Existing Contract Import Capability and Pre-RA Import Commitment Capability should be transferable. The CAISO believes it should be to maximize the efficient utilization of import capability by those LSEs that value it the most. However, the CAISO agrees with the CPUC that whether Pre-RA Import Commitment Capability should retain its preferred status warrants further discussion. If a substantial volume of Pre-RA Import Commitment Capability changes hands in contrast to Remaining Import Capability, the CAISO commits to revisit this issue. Absent proof of such behavior, the CAISO believes the Amendments as presented are just and reasonable and not unduly discriminatory.

3. Definition of RA Entity Load Share Percentage

The CPUC complains that the definition of RA Entity Load Share Percentage is inappropriately tied to load ratio data from 2005 so that it cannot be updated with more recent load data. This concern does not withstand scrutiny. The term RA Entity Load Share Percentage is not used in the Amendments or the import capability process at all.

Rather, the term is utilized in the context of the ISO Tariff provisions related to the Reliability Capacity Services Tariff. (*See* ISO Tariff Section 43.7.2.3.1.) Thus, no change to the ISO Tariff is necessary to ensure the appropriate functioning of the import capability assignment process under the Amendments.

4. The Clarifications to Step 13 Are Appropriate

The second paragraph in Step 13 of Section 40.5.2.2.1 provides, in pertinent part,

> If the request [for Balance of Year Unassigned Available Import Capability] is not honored because the branch group requested was fully assigned, the request will be deemed withdrawn and the Scheduling Coordinator will be required to submit a new request for unassigned import capability on a different branch group.

The CPUC raises several issues regarding this language.[15] First, the CPUC asserts that the language implies that there may be other reasons for the CAISO to have denied the request, other than because the branch group was already over-requested. The CAISO respectfully disagrees. The language simply defines the sole reason for the rejection. Second, the CPUC objects to the term "deemed denied" and requests that the CAISO clarify whether there is any additional implication in the term. There is no additional implication and the term used is "deemed withdrawn." "Deemed withdrawn" is intended to have the same meaning as "rejected." However, if the Commission believes the term "rejected" is substantively different than "deemed withdrawn," the CAISO consents to make such a change. Third, the CPUC does not understand why the Scheduling Coordinator would be "required" to submit a new request, rather than

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15 CPUC Comments at 7.

permitted to do so if it still seeks additional import capability. The CAISO agrees that this is the intent of the language and proposes the following change:

> If the request is not honored because the branch group requested was fully assigned, the request will be deemed withdrawn and the Scheduling Coordinator, <u>if it still seeks to obtain unassigned Available Import Capability</u> will be required to submit a new request for unassigned Available I~~i~~mport ~~c~~Capability on a different branch group.

Finally, the CPUC requests that the CAISO clarify that "it is the duty of the CPUC to evaluate whether a LSE under its jurisdiction has complied with or violated the CPUC's criteria for excessive reliance on import capacity to satisfy its RA requirements."[16] While the CAISO strongly agrees with the division of responsibility reflected in the CPUC's comments, it does not believe a change to the ISO Tariff is warranted. The ISO Tariff governs the scope of CAISO authority. It cannot, and should not, indicate the duty of the CPUC or attempt to outline the scope of the prohibitions to CAISO action. The ISO Tariff as written properly states the extent of the CAISO's affirmative authority.

16 CPUC Comments at 8.

IV. CONCLUSION

For the foregoing reasons, the CAISO respectfully requests that the Commission accept the Amendment with an effective date of May 22, 2007, subject to the foregoing modifications, which shall be filed pursuant to a subsequent filing in compliance with the Commission's determinations.

Respectfully submitted,

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Dated: April 27, 2007

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 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 27th day of April, 2007.

/s/ Susan Montana
Susan Montana