UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket No. ER06-615-___**
	)	**Docket No. ER02-1656-___**

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

Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.213 (2006), the California Independent System Operator Corporation ("CAISO")[1] respectfully submits this Motion for Leave to File Answer and Answer to Requests for Clarification and Rehearing of the Commission's September 21, 2006, order in the above-identified dockets, 116 FERC ¶ 61,274 (2006) ("September 21 Order").

I. MOTION FOR LEAVE TO FILE ANSWER TO REHEARING REQUESTS

Although an answer is permitted to Requests for Clarification, the CAISO recognizes that, unless authorized by the Commission, Rule 213(a)(2), 18 C.F.R. §385.213(a)(2), of the Commission's Rules of Practice and Procedures precludes an answer to a 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, *Southwest Power Pool, Inc.*, 89 FERC ¶ 61,284 at 61,888 (2000);

[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the MRTU Tariff.

Eagan Hub Partners, L.P., 73 FERC ¶ 61,334 at 61,929 (1995), or assist the Commission, *El Paso Electric Co.*, 72 FERC ¶ 61,292 at 62,256 (1995). Most of the requests for rehearing of the September 21 Order simply restate arguments that the Commission already has fully considered in accepting, subject to modification, the CAISO's tariff to implement its Market Redesign and Technology Upgrade ("MRTU") initiative. The CAISO has previously responded to these arguments in its May 16, 2006 Reply Comments in this proceeding ("CAISO Reply Comments") and its June 2, 2006 Answer to Reply Comments ("CAISO Answer to Reply Comments"). The CAISO sees no need to respond to the vast majority of these arguments. Certain rehearing requests, however, raise new or modified arguments opposing elements of the MRTU Tariff, misstate or mischaracterize an issue on the record or an element of the Commission's September 21 Order, or raise issues based on information that was not previously in the record in this proceeding. In these cases, the CAISO believes the Commission's consideration of these rehearing requests will benefit from a response from the CAISO. In particular, the CAISO believes it is appropriate to respond to many of the policy issues and arguments raised in requests for rehearing of the Resource Adequacy ("RA") provisions of the MRTU Tariff because of the critical role RA plays in the overall MRTU design. In each case, the CAISO's Answer provides additional information regarding the issues raised by the rehearing requests. Because this Answer clarifies the issues and thereby assists the Commission's evaluation of rehearing requests, the Commission should accept this Answer.

II. ANSWER

As an initial matter, the CAISO wishes to emphasize that any requests for rehearing of the September 21 Order must overcome the Commission's well-reasoned and detailed consideration of the issues and the voluminous record in this proceeding reflected in the Commission's nearly-400 page order on the MRTU Tariff. Even where the Commission had previously addressed issues related to the MRTU design, in some cases in multiple orders, the Commission considered these issues again *de novo* in approving the MRTU Tariff.[2] Some parties allege that the Commission reversed the applicable standard of proof and required protestors to demonstrate that the MRTU Tariff is unjust and unreasonable rather than requiring the CAISO to show that the MRTU Tariff is just and reasonable.[3] The CAISO filed over 750 pages of testimony and several hundred pages of additional supporting exhibits in support of the justness and reasonableness of the MRTU Tariff. In addition, there is existing Commission precedent for the design elements of MRTU. The Commission applied the appropriate statutory standard, set forth in Section 205 of the Federal Power Act, in concluding that the terms and conditions of the MRTU Tariff (with certain modifications) are just and reasonable and in rejecting arguments those terms and conditions are not just and reasonable. The Commission expressly held, "we find the MRTU Tariff, as modified by the CAISO in accordance with the directives contained in this order, to be just and reasonable, and that parties have failed to demonstrate that the tariff is unjust and unreasonable."[4]

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[2] September 21 Order at P 34 n.44.

[3] *See, e.g.,* the Rehearing Requests of SMUD, Cities/M-S-R, the Control Area Coalition, and the Losses Coalition.

[4] September 21 Order at P 25.

Some parties also allege that the Commission has not explained how it can resolve the factual issues in this proceeding without a hearing or further procedures or contend that certain statements the CAISO has made in support of the MRTU Tariff should be challenged through an on-the record technical conference.[5] These claims are without merit. The Commission considered literally thousands of pages of initial and reply comments on the MRTU Tariff, including testimony submitted by the CAISO and by those opposing elements of the MRTU Tariff. The Commission not only expressly authorized two rounds of comments on the filing, it also accepted a third round of filings by accepting all answers to reply comments in this proceeding.[6] Based on this record, the Commission concluded:

> . . . there is no need to reject, suspend or defer action on the tariff. We also find it unnecessary to set the tariff for hearing. Parties have provided thousands of pages of testimony and exhibits in this proceeding, both supporting and opposing specific aspects of the tariff filing. While the sheer number of pages of filings and testimony alone does not resolve factual disputes, we have found the record sufficient to make determinations, and to direct compliance filings, where necessary, to modify the tariff.

Id. at P 25. The Commission's approval of the MRTU Tariff is fully consistent with precedent confirming the Commission's authority to resolve factual disputes based on a written record.[7]

The CAISO appreciates the substantial effort that went into finalizing the order on the MRTU Tariff filing by September 21. The CAISO has previously emphasized the benefits to all parties of timely Commission action on MRTU issues. For similar

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5 *See, e.g.,* the Rehearing Requests of SMUD, the Control Area Coalition, and Williams.

6 September 21 Order at P 23.

7 *Cities of Carlisle and Neola v. FERC*, 741 F.2d 64 at 431 (D.C. Cir. 1982)(stating that the Commission has the power "to resolve the issues based on only a paper hearing"); *Cities of Batavia v. FERC*, 672 F.2d 64 at 91 (D.C. Cir. 1981)(finding a paper hearing sufficient and stating that petitioners had no right to a formal hearing or trial-like procedures).

reasons, it would be in the interests of all concerned for the Commission to issue a prompt decision on the requests for rehearing and clarification of the September 21 Order.

A. The Commission Appropriately Determined That Participants with "Balanced" Self-Schedules Should Not be Granted a Priority in the Event of Non-Economic Adjustments

In the September 21 Order, the Commission addressed an argument raised by several parties that under MRTU, in situations in which the CAISO has to curtail demand, the CAISO should grant parties with "matched" supply and demand a higher priority, curtailing first those parties with "unmatched" demand. The Commission properly rejected this argument, agreeing with the CAISO that granting such priority could: (1) undermine the CAISO's ability to optimize the use of supply resources, (2) incent parties to always self-schedule, and (3) as a result, adversely impact the CAISO's ability to optimize the use of supply resources to meet demand, provide reserves, and clear congestion.[8] Nevertheless, as the Commission noted and approved, the CAISO did propose to allow, in the Integrated Forward Market ("IFM") optimization process, self-scheduled CAISO demand to have higher scheduling priority for RA resources over self-scheduled exports to ensure that Load-Serving Entities ("LSEs") within the CAISO Control Area can utilize Resource Adequacy ("RA") resources when needed for CAISO grid reliability.[9]

In their rehearing request, the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California ("Six Cities") challenge the Commission's rejection of a curtailment priority for "balanced" self-schedules, contending that although the

[8] September 21 Order at P 116.

[9] *Id*.

CAISO's proposed solution is adequate for Release 1 of MRTU, the Commission should require the CAISO to adopt a priority for "balanced" self-schedules expeditiously after the initial implementation of MRTU.[10] The Commission should deny Six Cities' request. Six Cities contends that the notion that permitting matched supply and demand schedules to be curtailed only after unmatched schedules will act as an incentive to self-schedule is "speculative" because, according to Six Cities, there are factors other than the threat of non-economic intervention by the CAISO that drive the decision to self-schedule. Short of its unconvincing response to the CAISO's rationale for not granting a priority to matched schedules, Six Cities presents no new explanation as to why a curtailment priority for matched schedules is appropriate or necessary. The Commission has previously rejected granting scheduling priorities to subsets of Market Participants, such as the proposed scheduling priority for transmission rights holders,[11] and there is no compelling reason why Market Participants with matched supply and demand should be granted more favorable treatment than other Participants. The Commission should reject Six Cities' request for rehearing on this issue.

B. The Commission Should Not Require the CAISO to Include RUC Commitments in Calculating Day-Ahead Clearing Prices

In the September 21 Order, the Commission agreed with commenters that the fact that Residual Unit Commitment ("RUC") commitments are not reflected in Day-Ahead clearing prices may provide an incentive to LSEs to under-schedule in the Day-Ahead Market.[12] The Commission stated that convergence bidding "is the appropriate mechanism" to address this incentive in the long-run, and also required the CAISO to

[10] Six Cities Request for Rehearing at 19-20.
[11] *California Independent System Operator Corp*., 105 FERC ¶ 61,140 (2003) at PP 184-185.
[12] September 21 Order at P 181.

file an interim proposal to counter this incentive until convergence bidding can be implemented.[13] In their rehearing request, Constellation/Mirant requests that FERC clarify that the implementation of convergence bidding does not replace the need for the CAISO to reflect the impact of RUC commitments on the Day-Ahead Locational Marginal Prices ("LMPs"), and urges the Commission to direct the CAISO to modify the LMP calculations to include RUC commitments within 12 months of Release 1.[14]

The Commission should deny Constellation/Mirant's request. Constellation/Mirant does not appear to challenge the Commission's finding that convergence bidding, along with the Commission-ordered interim solution, is the appropriate long-term mechanism to address the incentive for LSEs to under-schedule in the day-ahead market. The only rationale that Constellation/Mirant provides for its argument that RUC commitments should be incorporated in day-ahead prices is the vague and unsupported assertion that LMPs will not accurately reflect the dispatch price of the marginal unit unless RUC commitments are included. This argument is incorrect. LMPs are appropriately calculated based on the marginal unit selected in the IFM optimization process to serve demand scheduled in the Day-Ahead timeframe. Moreover, the Commission clearly states that while it agrees with Constellation/Mirant's concern that the inability to reflect energy prices from RUC commitments into the day-ahead LMPs *may* provide an incentive to LSEs to underschedule, it also finds that convergence bidding as directed in its order is the appropriate mechanism for addressing this underscheduling. Moreover, Constellation/Mirant appears to be requesting that the CAISO implement a mechanism which CAISO considered but did

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13 *Id*.

14 Constellation/Mirant Request for Rehearing at 5-6.

not pursue because of implementation difficulties as also experienced in other ISOs as confirmed by LECG in its "Comments on the California ISO MRTU LMP Market Design". [15] For these reasons, Constellation/Mirant's request for clarification should be denied.

C. NCPA's Concern With Respect to the Scheduling Priority For Exports under MRTU is Not Ripe For Review

In its rehearing request, NCPA states that the fact that exports from resources that are not designated as RA or RUC will not be subject to an inferior scheduling priority "will help alleviate the discrimination against [the City of] Roseville in terms of scheduling cuts."[16] NCPA states, however, that "problems could arise . . . if the SMUD/Western control area, in which Roseville is situated, institutes its own Resource Adequacy requirements and if the CAISO prohibition would apply to resources designated under that program."[17] NCPA nevertheless acknowledges that "since this is not a problem at this time, this issue is less pressing."[18]

This issue is too speculative for the Commission to address at this time. NCPA has not identified any current flaw in the MRTU design, or the Commission's approval of that design. A more appropriate forum in which to raise this concern might be the upcoming technical conference on seams established by the Commission in the September 21 Order.

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15 http://www.caiso.com/docs/2005/02/23/200502231634265701.pdf
16 NCPA Rehearing Request at 20.
17 *Id*.
18 *Id*.

D. The Commission Should Re-Confirm That a Unit That Receives an Exceptional Dispatch is Not Eligible to Set the Market Clearing Price.

In the September 21 Order, the Commission correctly concluded that Exceptional Dispatches should not be permitted to set the market clearing price under MRTU:

> We also disagree with WPTF/IEP and Constellation/Mirant that Exceptional Dispatches should be allowed to set the market price. LMPs should reflect the marginal cost of energy, in order to send accurate price signals. However, manual Exceptional Dispatch instructions differ from those derived from the real-time market optimization software. Units manually dispatched in Exceptional Dispatches need not represent the marginal units, and thus, we agree with the CAISO that it would not be appropriate for such units to set the market price.[19]

Constellation/Mirant submits a request for clarification that is essentially a request for rehearing of this finding. Specifically, they request that, when a unit that receives an Exceptional Dispatch is the "marginally priced unit," it should set the applicable LMP market clearing price.[20] Constellation/Mirant further requests that, if this "clarification" requires any specific modifications to the MRTU software or settlements, such modifications will be made no later than 12 months after MRTU Release 1.

The requested clarification is inconsistent with the fundamental nature of the system-wide optimization performed by the MRTU software. Exceptional Dispatches are, by their very nature, designed to cope with events that occur outside of normal market operations. These dispatches do not respond to general scarcity conditions, but are designed to address specific reliability problems that cannot be fully anticipated in advance. Because these dispatches do not accurately reflect the system-wide need, it would be inappropriate and disruptive to allow such dispatches to set the LMP. Indeed, such an approach would send inaccurate price signals. For these reasons, the

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[19] September 21 Order at P 266.

[20] Constellation/Mirant at 6-7.

Commission should reaffirm its finding in Paragraph 266 of the September 21 Order and confirm that Exceptional Dispatches cannot and should not set the market clearing price under MRTU.

E. The Commission Should Reject SMUD's Request that the CAISO be Directed to Modify Release 1 Such That UFE Costs Are Not Allocated to Load Outside the CAISO Control Area Operating Behind Revenue Quality Meters

In its request for rehearing, the Sacramento Municipal Utility District ("SMUD") argues that the Commission should direct the CAISO to modify MRTU Release 1 so that Unaccounted For Energy ("UFE") costs are not allocated to entities outside the CAISO Control Area who operate behind revenue qualify meters. SMUD contends that, for the same reason that it is unreasonable to allocate RUC costs to load outside the CAISO Control Area, there is no logical basis for allocating UFE costs to load outside the CAISO control area that operate behind revenue quality meters.[21]

SMUD is incorrect in its assertion that it is unreasonable to allocate UFE costs to entities outside the CAISO Control Area because the Commission found it unreasonable to allocate RUC costs to such entities. A distinguishing feature between the allocation of RUC costs and UFE, which is the salient feature in the Commission's directive to require the CAISO not to allocate RUC costs to exports,[22] is that the CAISO does not commit additional resources in RUC to meet export needs. This is simply not the case for UFE. UFE is caused on the system by a number of reasons such as meter measurement errors, load profile errors, Energy theft, and distribution loss

[21] SMUD Rehearing Request at 35-56.
[22] September 21 Order at P 171.

deviations, all of which may be related to exports on the system. SMUD has raised no evidence that UFE is not caused by exports. Therefore, there is simply no justification for treating the two cost allocations similarly.

F. The Commission Should Uphold its Conclusions Concerning Ancillary Services Issues

1. Ancillary Services Cost Allocation

Williams requests rehearing regarding the Commission's determinations that: (i) CAISO-procured Ancillary Services support the use of the entire CAISO Control Area, and (ii) it is appropriate to allocate the costs associated with Ancillary services procurement to all Load in the CAISO Control Area.[23] The CAISO respectfully suggests that there is no need for the Commission to reverse its determinations regarding Ancillary Service ("AS") cost allocation.

With the functionality embodied in the MRTU design, the Commission correctly found that it is reasonable to allocate AS procurement costs to all Loads on a system-wide (or Control Area) basis. First, AS requirements satisfied in a smaller AS Region satisfy or count towards the AS requirement in a larger AS Region (*e.g.*, the System Region which is the CAISO Control Area). This means that regionally-procured AS counts toward meeting the AS requirements for the larger, System Region for the particular service. Second, Williams fails to account for the fact that AS will be co-optimized with Energy under MRTU (as opposed to sequential optimization under the existing pre-MRTU tariff), across all regions (as opposed to zonal procurement when AS procurement is split today) for the most efficient market outcome. In other words,

[23] *See* Williams Request for Rehearing at 39-41 (seeking rehearing of the September 21 Order at P 309).

whether and where AS capacity is awarded depends on co-optimization that minimizes both Energy and AS bid costs and meets the Energy and AS needs of the system.[24] Third, the AS requirements are: (i) based on Western Electricity Coordinating Council ("WECC") and North American Electric Reliability Council ("NERC") standards; (ii) System Region or Control Area wide requirements; and (iii) demand-based requirements according to Control Area demand.[25] The requirements do not vary with the size of any particular Load; each requirement will apply equally to all Loads in the CAISO Control Area. In sum, the AS requirements for a particular service are "system" requirements and it is reasonable to allocate costs of meeting the system requirements on a system basis to Load in the CAISO Control Area.

Williams' attempt to use the Commission's determination regarding the use of AS Regions (September 21 Order at P 380) as a means to revisit the Commission's determination on AS cost allocation (September 21 Order at P 309) should be rejected. In Paragraph 380 of the September 21 Order, the Commission noted that the granularity of AS regions and sub-regions can have an impact on AS costs. However, the Commission also noted that this is not entirely different from the impact of binding transmission constraints on energy prices.[26] The Commission stated that *if* the CAISO were not to enforce transmission constraints in procuring AS, it could procure AS in the

[24] The elimination of the existing sequential optimization of Energy and AS means that the system won't look only at relative capacity costs in establishing AS awards. Depending on the relative efficiency of providing Energy or AS, co-optimization may mean that a generating unit with a lower AS cost may not receive an AS award if it is more efficient overall to have that unit provide Energy instead of AS. *See* Testimony of Dr. Rahimi, Exh. ISO-4 at 121-122, 125-131.

[25] *See, e.g.*, CAISO Reply Comments at 154-155

[26] September 21 Order at P 380.

wrong locations. *Id*. However, under MRTU the CAISO *will* enforce applicable constraints in procuring AS and will not procure AS in the wrong locations.[27]

As noted in previous pleadings, the legal standard is not whether there are other methods of recovering AS procurement costs for the CAISO Control Area that are just and reasonable or whether there are arguably better approaches, the issue is whether the method proposed by the CAISO in the MRTU Tariff is just and reasonable. For the reasons expressed in the September 21 Order and herein, the CAISO respectfully requests that the Commission not alter its determination regarding AS cost allocation.

2. Self-Provision of Ancillary Services

In the MRTU filing, the CAISO explained that there would be a limitation on the self-provision of imported AS from outside the CAISO Control Area for Release 1 of MRTU. [28] In its reply comments, the CAISO: (i) recognized that this aspect of the MRTU design limited functionality as compared to the existing (pre-MRTU) Tariff, (ii) explained, however, that to allow imports of self-provided AS with the Release 1 software would lead to an inefficient allocation of intertie transmission capacity, and (iii) noted that while it is not exactly identical to being able to self-provide AS via an import, Scheduling Coordinators that otherwise would plan to import self-provided AS will have the option of

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[27] *See, e.g.*, section 8.3.3 of the MRTU Tariff which provides in part that "[t]he considerations and criteria the CAISO will use to establish Sub-Regions and regional limits include, but are not limited to, *an assessment of resource operating constraints,* the locational mix of Generating Units, generation outages, historical patterns of transmission and Generating Unit availability*, regional transmission limitations and constraints,* Available Transmission Capacity, and other factors affecting reliability" (emphasis added); *see also*, October 23, 2006 CAISO Request for Clarification and Rehearing at 25-26 (explaining that all AS will be subject to regional constraints, including self-provided AS).

The CAISO also notes that it will comply with the Commission's directives in P 380 of the September 21 Order regarding revising the MRTU Tariff to include a description of: (i) how the Full Network Model optimization will apply to reserves as it does to energy; (ii) how the CAISO will determine the definition of an ancillary services region or sub-region if the Full Network Model optimization does not apply to reserves; and (iii) the circumstances under which it will become necessary to define more granular zones for ancillary services procurement.

[28] *See* February 9, 2006, MRTU Transmittal Letter at 53; Testimony of Dr. Rahimi, Exh. ISO-4 at 117.

bidding the imports of AS into the market at $0 (or a negative) price.[29] The Commission accepted the CAISO's proposal regarding the self-provision of AS imports for Release 1 of the MRTU Tariff.[30]

In its request for clarification, the Western Area Power Administration ("WAPA") notes that entities with existing transmission contracts ("ETCs") can self-provide AS imports under MRTU if it is within their contractual rights.[31] WAPA then explains that under the existing, pre-MRTU Tariff, its Boulder Canyon Project customers are allowed to self-provide AS even though such transactions do not take place under an ETC. WAPA asks the Commission to clarify that its customers can continue to self-provide AS imports from WAPA's Boulder Canyon Project for Release 1 of MRTU. The CAISO respectfully suggests that the clarification requested by WAPA is not necessary. The Commission accepted the CAISO's proposal regarding the limitation on self-provision of AS imports for Release 1 as well as the CAISO's commitment to work on re-establishing this functionality in Release 2.[32] In the meantime, WAPA will have the option to try to approximate the self-provision of AS imports by bidding its imports of AS into the market at $0 (or a negative) price.

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[29] *See* CAISO Reply Comments at 145-147; *see also* September 21 Order at PP 314-317. In addition, the CASIO committed to investigate allowing self-provision of AS over the interties; the issue was on the list of items to be considered as part of the Release 2 of MRTU software. February 9, 2006 MRTU Transmittal Letter at 95-96.

[30] September 21 Order at P 324.

[31] *See* WAPA Request for Clarification at 6-7.

[32] September 21 Order at P 324.

G. The Commission Should Reject Requests to Impose an Inter-SC Trade Settlement Service at the Interties

In the September 21 Order, the Commission concluded that "settlement services for Inter-SC Trades at interties are unnecessary."[33] This finding is consistent with the conceptual Inter-Scheduling Coordinator Trade rules accepted by the Commission in its June 10, 2005 order.[34] In making this finding, the Commission expressly considered and rejected arguments raised by SMUD, Turlock and others that the CAISO should be required to add settlement services for Inter-SC Trades at the interties.[35] As the CAISO pointed out in its Reply Comments in this proceeding, arguments raised by SMUD and Turlock had previously been considered and rejected in the June 10, 2005 Order.[36] Moreover, as the CAISO also explained in those Reply Comments, the CAISO currently does not provide Inter-SC Trade services at interties.[37]

On rehearing SMUD and Turlock try once more to have the Commission impose an Inter-SC Trade settlement service for the interties. SMUD claims that the Commission relied solely on the fact that the CAISO's current market design does not include Inter-SC Trades at the interties and that the Commission ignored the impact of the lack of such settlement services on existing contracts and on wheel-though transactions.[38] This is not true. The lack of an existing Inter-SC Trade mechanism at the interties is simply one of multiple reasons that the Commission rejected SMUD's

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33 September 21 Order at PP 469.

34 111 FERC ¶ 61,384 at P 24 ("June 10, 2005 Order").

35 *See* September 21 Order at PP 464 to 466 (describing these protests) and PP469 to 470 (rejecting these protests).

36 CAISO Reply Comments at 246-247.

37 *Id.* at 247. *See also*, Exhibit No. ISO-6 at pp. 97-98.

38 SMUD Rehearing Request at 42-47; *see also* Burbank/Turlock Rehearing Request at 10.

protest.[39] The Commission first explained why it again concluded that bilateral transactions at the interties can be accommodated under MRTU without an Inter-SC Trade mechanism.[40] The Commission also noted that such a feature was not supported by most Market Participants through the MRTU stakeholder process.[41] SMUD claims that the Commission erred in dismissing as moot SMUD's request for rehearing of the June 10, 2005 Order.[42] This dismissal was appropriate, however, because the Commission considered SMUD's arguments on Inter-SC Trades *de novo* as part of its consideration of the detailed terms and conditions of the MRTU Tariff.

Turlock contends that the Commission erred because it did not consider Turlock's protest concerning the potential impacts on exports of the CAISO's decision not to develop a new feature for Inter-SC Trades at the interties.[43] It is clear, however, that the Commission considered the arguments raised by Turlock and others and decided that "Protestors have not persuaded us otherwise [*i.e.*, to abandon the conceptual Inter-SC Trade design approved in the June 10, 2005 Order]."[44] Turlock's rehearing request is simply "another bite at the apple" which raises no new issues that the Commission has not already considered.

The CAISO would like to emphasize one further reason why the Commission should not reverse its decision that Inter-SC Trade settlement services at the interties are not needed. The Commission's June 10, 2005 Order accepting the conceptual Inter-SC Trade mechanism was designed to be an integral component of the "Seller's

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39 September 21 Order at P 470 ("We *also* note that, under its current market design, the CAISO does not provide settlement services at interties.") (emphasis added).
40 *Id.* at P 469.
41 *Id.* at P 468
42 September 21 Order at P 470 n. 222.
43 Burbank/Turlock Rehearing Request at 7-12.
44 September 21 Order at P 470.

Choice" settlements. Because the Commission-approved mechanism did not provide for Inter-SC Trades at the interties, there is a very real risk that adopting the change proposed by SMUD and Turlock could unravel the Seller's Choice settlements. The Commission therefore should reject the rehearing requests of SMUD and Turlock on this issue.

H. The Commission Should Not Impose Duplicative Reporting Requirements on the CAISO

Pacific Gas And Electric Company ("PG&E") requests that the Commission "direct the CAISO to have its Department of Market Monitoring, Market Surveillance Committee, and operations staff file [ ] quarterly periodic reports on any effects of the MRTU program on reliability, market prices, or market manipulation resulting from inter-control area operations."[45] This requirement is not needed in view of already-established reporting and monitoring requirements and procedures.

During the first year of MRTU implementation, PG&E's request would duplicate an existing reporting requirement. The Commission has already required the CAISO "to submit quarterly reports evaluating MRTU performance and operational issues for the first year and providing information on corrective actions."[46] For the following years, it is important to recall that the Department of Market Monitoring ("DMM") is charged with monitoring all factors that could impact the efficiency of the CAISO's markets, including inter-Control Area operations.[47] In performing this function, DMM will coordinate with the Market Surveillance Committee, CAISO operations staff, and other CAISO

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45 PG&E Rehearing Request at 4.
46 September 21 Order at P 1417.
47 *See* generally Section 38 of the MRTU Tariff.

departments. To the extent DMM identifies market structure flaws, including the potential for market manipulation, DMM is required to provide such evidence to the CAISO CEO and/or the CAISO Governing Board. After due internal consideration, DMM will provide such evidence to the Market Surveillance Committee and the appropriate regulatory enforcement agencies, including the Commission.[48] PG&E's proposed quarterly reporting requirement will add nothing to this rigorous market monitoring and reporting structure but could require CAISO personnel to expend scarce resources on reporting efforts when the DMM has not identified market flaws. For this reason, the Commission should deny PG&E's request for additional quarterly reports.

I. The CAISO Will Work with Stakeholders to Resolve Issues Raised by NCPA With Respect to Real-Time LAP Pricing

In its Request for Rehearing, the Northern California Power Agency ("NCPA") states that it "has identified and brought to CAISO's attention some problems with the real-time LAP settlement price formulas." Specifically, NCPA states that Load Aggregation Point ("LAP") settlement purchase prices can result in a LAP price for power higher than the highest nodal price within the LAP, sometimes to an extreme, and similarly, the LAP sale prices can be lower, or even much lower, than the lowest nodal price within the LAP. NCPA notes its understanding that the CAISO has developed a proposed solution to these problems, but "raises the issue to preserve it."[49]

In response to NCPA's request that the CAISO address an issue they identified regarding the real-time LAP pricing, the CAISO has been working with NCPA to explore

[48] *See* Section 38.2.3 of the MRTU Tariff.
[49] NCPA Request for Rehearing at 24.

the magnitude of the issue and consider solutions. Following internal review of the issue and the recommended solutions, on October 26, 2006, the CAISO posted a draft whitepaper containing proposed solutions to this issue. The CAISO is scheduled to discuss this whitepaper with MRTU stakeholders in an upcoming stakeholder meeting. After having completed its stakeholder process on this issue, the CAISO will file any required tariff changes with Commission for approval. While this is an issue that the CAISO believes needs to be addressed, the likely occurrence of extreme prices that can result is very minimal. Therefore, it is not necessary for the Commission to reverse its conditional approval of the real-time pricing proposal in the September 21 Order.

J. The CAISO is Exploring Solutions to Allow RMR Resources to Also Act as Load-Following Resources

Silicon Valley Power ("SVP") contends that the Commission erred in finding that a Reliability Must-Run ("RMR") resource cannot be designated as a load-following resource. As noted by SVP, however, the CAISO has been engaged in discussions with NCPA concerning this issue, in order to attempt to work out a solution that would allow Metered Subsystems ("MSSs") to designate RMR resources as load-following.[50] The CAISO plans to discuss this issue with interested stakeholders as part of the ongoing stakeholder process dealing with MSS-related issues. Depending on the results of this process, the CAISO may propose adding RMR/load-following functionality in a filing to be made with the Commission sometime prior to the implementation of Release 1. Therefore, the CAISO requests that the Commission defer decision on

[50] Rehearing Request of the Cities of Redding and Santa Clara and M-S-R Public Power Agency ("Cities/MSR") at 82-84. In this pleading, the City of Santa Clara d/b/a Silicon Valley Power submitted independent requests for rehearing.

SVP's request until such time as the CAISO concludes its discussion of this issue with its stakeholders.

K. Participating Load Issues

The State Water Project ("SWP") raises a number of issues related to Participating Load. As an initial matter, the CAISO notes that it is following through with the Commission's directive to work with SWP "to improve the MRTU Tariff's handling of the unique constraints posed by participating load and to make a compliance filing" reflecting these discussions.[51] These discussions have already been quite productive and the CAISO hopes to resolve many of the concerns raised by SWP through this process and the subsequent compliance filing. The CAISO does believe the Commission will benefit, however, from a response to certain of the issues raised in SWP's rehearing request.

SWP contends that the term "Base Load" should be removed from the MRTU Tariff because it promotes confusion concerning the settlement of Participating Load.[52] The CAISO concurs with SWP, and commits to removing this term from the MRTU Tariff as part of its upcoming 60-day compliance filing.

SWP argues that the Commission should clarify that RUC costs and other costs either should not be allocated to SWP or should reflect Participating Load schedules in the Hour-Ahead Scheduling Process ("HASP").[53] This request is based in large part on

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51 September 21 Order at P 703.
52 SWP Rehearing Request at 31-32.
53 *Id*. at 34-40.

SWP's understanding that Participating Load will be able to self-schedule and bid in the HASP time frame.[54]

As the CAISO explained in the July 14, 2006 responses to MRTU Questions (posted on the CAISO Home Page at: http://www.caiso.com/17ca/17cad0e473390.pdf):

> Participating Load that uses the pump-storage model may submit Self-Schedules to Supply or Demand Energy, and Self-Provision of Ancillary Services.
>
> The HASP and RTM clears Supply against the CAISO forecast of Real Time CAISO Demand and not bid-in CAISO Demand as does the IFM. Therefore, in most cases, SCs may not submit Demand Bids in the HASP and RTM. Participating Load using the pump storage model is an exception to this rule in that it can submit Self-Schedules of Demand for Energy in the pumping mode. This must be entered as a single segment Bid (either an Economic Bid or Self-Schedule which is either ON or OFF)

As this response suggests, Participating Load can be bid or self-scheduled either as Demand or Supply. To the extent that the Participating Load is cleared from the IFM with a Day-Ahead Schedule for Demand, they may submit a Bid in the HASP to curtail that Day-Ahead Schedule in order to offer Energy or AS in the HASP/RTM. To the extent SWP treats its Participating Load as a supply resource in this manner that part of the Participating Load will not be subject to RUC cost allocation. Therefore, if the bid submitted to the HASP/RTM for curtailment is accepted and consequently the Participating Load curtails its Day-Ahead Schedule (i.e., the pump is shut down), the pump is off and there will be no metered demand from that Participating Load. With respect to the first tier of the RUC uplift, there is no net negative CAISO Demand deviation. Similarly, because the pump is off, there is no ability to charge for tier 2 given that there is no metered CAISO Demand. On the other hand, if the bid to curtail is not accepted and the pump is not curtailed, then the Participating Load is not acting like

[54] *Id.* at 40.

supply and therefore any metered CAISO demand from that pump may be subject to RUC tier 2 uplift charges.[55] In this case, again tier 1 would not be applicable because there is no deviation from their Day-Ahead Schedule.

Finally, the CAISO believes it is necessary to reiterate that, except when the pump is acting as negative generation, if Participating Loads do not have a Day-Ahead Schedule, there is no ability to submit a Demand Bid in the HASP or RTM. In the event that the pump is acting as a negative generation and submits a Demand in HASP/RTM to pump in the real-time, any metered CAISO Demand from the pump is subject to tier 1 and tier 2 RUC uplift.

L. Issues Concerning Congestion Revenue Rights

The CAISO's Congestion Revenue Right ("CRR") proposal contained in the MRTU Tariff and conditionally approved by the Commission in the September 21 Order was the result of intensive policy development by the CAISO, deliberate and transparent consultation with and by stakeholders, and thoughtful consideration by the Commission. With that in mind, the CAISO is not responding to rehearing requests that simply question the Commission's ruling on the proposal. However, as set forth below, the CAISO is responding to certain discrete issues raised in rehearing requests that confuse the record.

1. CRR Allocation to Out of Control Area Load

In the MRTU Tariff, the CAISO provides entities representing load outside the CAISO Control Area (so-called "out-of-Control Area Load" or "OCAL" entities) the opportunity to receive allocated CRRs on similar, but not identical, footing as the

[55] *See* CAISO Reply Comments at 301.

CAISO's internal Load Serving Entities ("LSEs"). As the Commission properly recognized in the September 21 Order, the CAISO's proposal is not unduly discriminatory in its treatment of LSE's with load internal to the CAISO Control Area as compared to OCAL entities.[56] Both internal and external loads are eligible to receive an allocation of CRRs and both are eligible to purchase CRRs at auction.

The differences in treatment reflect the fact that internal LSEs must use the CAISO Controlled Grid to serve their loads. In contrast, OCAL entities have the ability to serve their load without using the CAISO Controlled Grid. Therefore, OCAL entities have the potential avoid LMP-related congestion costs and wheeling access charges ("WAC"), except when serving their outside load from resources internal to the CAISO Control Area. The inherently different factual circumstances between internal and external loads require that OCAL entities pre-qualify for the CRR Allocation by prepaying access charges and making a showing of legitimate need by demonstrating ownership of, or contract with, certain generators that would require the use of the CAISO Controlled Grid.[57]

SMUD's Request for Rehearing contains assertions that misstate the provisions of the MRTU Tariff. SMUD essentially asserts that they are unable to obtain CRRs for their wheel-through transactions. This is not correct. All creditworthy parties may bid to obtain CRRs through the auction, including wheel through CRRs that use an import as source and an export as sink. SMUD's statements would have the Commission believe otherwise and this is simply not the case

[56] September 21 Order at PP 766-769.
[57] CAISO Reply Comments pp. 73-79.

The Imperial Irrigation District ("IID") requests rehearing regarding several aspects of the OCAL allocation but its pleading contains several errors, demonstrates a misunderstanding of the MRTU Tariff and only confuses the record. First, IID claims that the MRTU Tariff places OCAL entities "on the same level as non-load serving entity, such as a marketer."[58] This statement is false. Marketers and any other non-load serving entity (*i.e.*, entities that are not LSEs in the CAISO Control Area and are not load serving entities serving load outside the control area) are only able to obtain CRRs through the CRR Auction. As explained above, entities serving external load are *allocated* CRRs, like internal LSEs, to the extent of their legitimate needs and provided access charges are prepaid to ensure load obligations support the nominations. Second, IID's example suggests that the CAISO may somehow resell the "unscheduled CRR."[59] As described in more detail below, there is no such thing as an "unscheduled CRR" nor can the CAISO resell any CRR it has allocated. Third, IID states that "[i]f IID wants the perfect hedge for its non-ETC/TOR transmission, it will have to pay for both CRRs and the [WAC] up front."[60] Neither IID, nor any other entity, is entitled to perfect hedge treatment for non-ETC/TOR transmission service. This statement also is mistaken in that it implies that IID must prepay the Wheeling Access Charge ("WAC") *and* then still have to buy a CRR. OCAL entities that pre-pay the WAC are *allocated* (*i.e.* given) CRRs for which they can show a legitimate need (to the extent the nominations are simultaneously feasible and can thus be awarded). Thus, there is no double payment as IID suggests. Finally, IID also questions whether it can sell CRRs in the secondary market. The MRTU Tariff does allow such secondary market

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58 IID Request for Rehearing at 24.
59 *Id.*
60 *Id.* at 26.

transactions. The only obligation that the CAISO imposes on secondary market transactions is that the transactions be registered through the Secondary Registration System to ensure payments are made and charges are collected consistent with the Tariff. Regarding the prepayment of access charges for OCAL entities, SMUD and IID request rehearing and ask that the CAISO be ordered to refund prepaid access charges for something they call "unscheduled CRRs."[61] The general concept of the request seems to suggest a situation in which a CRR Holder does not schedule according to its CRR holdings. These requests should be denied.

A CRR is a financial tool that entitles its holder to a revenue stream in the form of a CRR Payment (or possibly a charge in the case of CRR Obligations). That CRR Payment is not conditioned upon its holder scheduling power in accordance with its source, sink, and quantity. Therefore, regardless of whether a CRR Holder schedules power in accordance with its CRR holdings, the CAISO pays that CRR Holder a CRR Payment in accordance with the MRTU Tariff. The prepayment mechanism complements the legitimate need showing by ensuring that the owned or contracted resources in question will actually use the CAISO Controlled Grid. As Dr. Lorenzo Kristov noted in his testimony accompanying the MRTU filing, without the prepayment mechanism, an OCAL entity with owned or contracted resources in the CAISO Control Area (or elsewhere in the case of a wheel-through) could sell their power off elsewhere while it also would collect a revenue stream from the allocated CRRs.[62] The combination of the legitimate need showing and the prepayment of access charges ensures that allocated CRRs go to load-serving entities (internal and external) as

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61 SMUD Request for Rehearing at 26-27; IID Request for Rehearing at 27-28.

62 Exh. ISO-1 at 91.

protection from the congestion charges on the CAISO Controlled Grid associated with serving their loads. Accordingly, refunding prepaid access charges would completely undermine this system by allocating CRRs to entities that may or may not use the CAISO Controlled Grid. In short, the requirements for OCAL entities to obtain allocated CRRs are reasonably tailored to the factual circumstances of such entities.

In its Request for Rehearing, IID suggests that the Commission treat all "native load service providers, whether inside or outside the CAISO similarly" with regard to the allocation of CRRs.[63] IID's statement implies that there is no distinction between load inside the CAISO Control Area and load outside the CAISO Control Area. Such an assumption is simply incorrect. As articulated in the Direct Testimony of Dr. Kristov, the fundamental difference between internal and external Load is the degree to which they are obligated to pay the embedded costs of the transmission in the CAISO Control Area.[64] Whereas internal Load cannot move one MW without the CAISO Controlled Grid, entities that serve external Load are fundamentally different because they are free to avoid access charges by contracting around the CAISO Controlled Grid, now and in the long-term.

Finally, SMUD has alleged that the CAISO designed its CRR program (which applies uniformly to *all* entities serving external load) to somehow retaliate against SMUD for leaving the CAISO Control Area.[65] While the CAISO regrets the need to address these claims yet again, it feels compelled to do so because SMUD's request amounts to a plea for indemnification for the appropriate consequences of SMUD's own decisions. The essence of SMUD's request is to ask the CAISO and its internal LSEs to

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63 IID, Request for Rehearing at 25.
64 Exh. ISO-1 at 91.
65 SMUD Request for Rehearing at 51.

hold SMUD financially and operationally harmless for any consequences of its decision to create its own Control Area. The CAISO proposal treats all OCAL entities similarly; SMUD's position is that the CAISO should discriminate *among* entities outside of the CAISO Control Area in order to accommodate SMUD's request to be treated like an internal LSE. SMUD is not being denied access to CRRs as it would have the Commission believe. Again, to the extent SMUD exports power from the CAISO Control Area, it may be *allocated* CRRs for those transactions. To the extent SMUD's internal resources and those inside the CAISO Control Area cannot meet SMUD's load, SMUD is free to wheel power across the CAISO Controlled Grid and hedge its exposure to congestion for these transactions by obtaining CRRs at auction.[66] The CAISO urges the Commission to continue to recognize that SMUD, as other OCAL entities, will have ample opportunity under MRTU to nominate and receive CRRs in the allocation and purchase CRRs at auction.

2. CRRs for Participating Loads

SWP requests rehearing on several issues regarding the inclusion of Participating Loads in the CRR Allocation process.[67] In the September 21 Order, the Commission recognized the CAISO's commitment to ensure that Participating Loads could participate in the CRR Allocation. September 21 Order at P 777. As SWP noted in its rehearing request, that collaboration process is ongoing, and the CAISO renews its prior commitment to incorporate Participating Loads into the MRTU model as provided for in the MRTU Order.

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[66] As the CAISO has previously stated, if SMUD's concern is really one of intertie capacity for wheel-throughs, the CRR Dry Run should shed light on intertie availability and the Commission has ordered the CAISO to reevaluate intertie capacity allocations at that time.

[67] SWP Request for Rehearing at 52-58.

3. Intertie Capacity

Powerex Corp. ("Powerex") seeks clarification regarding the Commission's approval of the CRR Allocation process and its treatment of intertie capacity in the allocation process. The MRTU Tariff calls for reserving fifty percent of the residual intertie capacity after load-serving entities make their source-verified nominations.[68] Specifically, Powerex asks the Commission to clarify that the Commission intended to approve a CRR program in which fifty percent of *all* intertie capacity would be set-aside in the CRR Allocation and made available in the CRR Auction.[69] Alternatively, to the extent the Commission does not so clarify, Powerex requests rehearing of the Commission's approval of the intertie capacity allocation contained in the MRTU Tariff.[70]

The CAISO reiterates that the "set-aside" mechanism for treatment of intertie capacity was accurately described in the MRTU Tariff and in the Commission's September 21 Order. The "set aside" of intertie capacity for the CRR Auction refers to fifty percent of the capacity remaining after allocation of capacity to LSEs through source-verified nominations. Powerex is correct that this amount may not equal fifty percent of *total* intertie capacity – indeed it may be more or less than fifty percent of total capacity depending on the source verified nominations by LSEs. As the CAISO has previously committed and as the Commission noted in the September 21 Order,[71] the CRR Dry Run will provide the most accurate assessment of whether the intertie capacity set-aside as formulated will leave sufficient capacity available at the auction.

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68 *See* MRTU Tariff at Section 36.8.4.1.
69 Powerex Request for Rehearing at 3-24.
70 *Id.* at 27-28.
71 September 21 Order at P 830.

The CAISO commits here again to reevaluate the intertie set-aside mechanism after the results of the CRR Dry Run are known.

M. The Commission Should Decline to Address Arguments Concerning Long-Term Firm Transmission Rights in This Proceeding

Several commenters raise issues concerning Long-Term Firm Transmission Rights ("LT FTRs") and Order No. 681[72] in their requests for rehearing of the September 21 Order. These issues go beyond the scope of the instant proceeding and should be addressed elsewhere. For example, SMUD argues that the Commission should have directed the CAISO in this proceeding to offer LT FTRs *before* MRTU is implemented.[73] SMUD also raises various issues related to white papers presented in the CAISO's LT FTR stakeholder process and the interpretation of Order No. 681. These issues are unrelated to the Commission's order on the terms and conditions of the MRTU Tariff. The CAISO is currently working, with stakeholder input, on the compliance filing required by Order No. 681 (a requirement which was reiterated in the September 21 Order), which is due in January 2007. Any issues related to the manner in which the CAISO will comply with Order No. 681 should be raised in response to that compliance filing. Similarly, any issues involving Order 681 itself should be considered in the LT FTR rulemaking docket.

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[72] *Long-Term Firm Transmission Rights in Organized Electricity Markets*, 116 FERC ¶ 61,077 (2006) ("Order No. 681").

[73] SMUD Rehearing Request at 37-41.

N. The Commission Should Deny Requests for Clarification and Rehearing Concerning Existing Transmission Contracts and Transmission Ownership Rights

In the MRTU Tariff, the CAISO sought to preserve the rights of Existing Transmission Contract ("ETC") holders while minimizing any detrimental effects ETCs have on the new market design. The Commission, first in its order on the CAISO conceptual proposal for ETCs[74] and then in the September 21 Order, conditionally approved the CAISO's approach.[75] With the exception of the CAISO's offer to clarify the MRTU Tariff provision implementing the "perfect hedge" protection for ETCs with Real-Time scheduling rights discussed below, the Commission should deny the requests for clarification and rehearing concerning ETCs and reaffirm the considered analysis of the September 21, Order.

1. The CAISO Agrees with the State Water Project and IID that the Perfect Hedge Should Accommodate ETCs with Scheduling Rights Beyond the CAISO Market Timeframes

The MRTU Tariff reflects the CAISO's commitment to permit ETCs to retain the scheduling rights specified in their respective agreements with the Participating TOs, even if those rights contain deadlines beyond those required for CAISO Market transactions. Section 16.9.1 states, "[t]hose holders of Existing Rights who have Existing Rights as reflected in the TRTC Instructions that allow scheduling after the close of the Day-Ahead Market may submit ETC Self-Schedules for the use of those rights by the deadline for the Market Close for the HASP." The CAISO also sought to protect ETCs from having to pay Congestions Charges by means of the "perfect hedge." As described by the Commission, "[t]he perfect hedge allows the CAISO to continue to

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74 *California Independent System Operator Corp.,* 110 FERC ¶ 61,113 (2005).

75 September 21 Order at PP 901-974.

honor ETC and TOR schedules and also hold ETCs and TORs harmless for congestion charges. This mechanism together with the scheduling provisions discussed above eliminates the current phantom congestion problem by making more transmission capacity available for market participants' use and enabling the CAISO to manage its grid more effectively."[76]

The State Water Project raises a concern with respect to the issue of "balanced" ETC Self-Schedules and the perfect hedge treatment. Specifically, SWP asserts that it is not possible to demonstrate a balanced HASP Schedule when only one side of the balance—the supply side—is permitted to be changed under the tariff in the HASP.[77] SWP worries that, because only the balanced portion of an ETC Self-Schedule receives perfect hedge treatment, it will be exposed to Imbalance Energy charges if it cannot adjust both the demand and supply sides of its ETC Self-Schedules within the timeframes permitted. Therefore, according to SWP, the MRTU proposal has failed its commitment to honor ETC service by holding it harmless from Congestion Costs associated with exercising hour ahead scheduling rights.[78] IID also asks clarification to be allowed to change both the demand or sink and the supply or source side of its schedule in the DAM, HASP, and Real-Time Market.[79]

The CAISO agrees that ETCs with rights that extend scheduling timeframes beyond the CAISO Market timelines will receive the perfect hedge protection against Congestion Charges consistent with their TRTC Instructions, and the CAISO believes that Section 11.5.7 is consistent with this principle. As currently written, Section 11.5.7

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[76] September 21 Order at P 942.
[77] State Water Project at 47-50.
[78] State Water Project at 49.
[79] IID at 51-56.

specifies that the applicable "Congestion Credit" will be applied to the full amount of the difference between the ETC holder's metered CAISO Demand and its Day-Ahead Schedule, so long as the amount of metered CAISO Demand does not exceed the constraints of either the ETC holder's ETC Self-Schedule in the HASP or the maximum ETC capacity specified in the TRTC Instructions. However, the CAISO recognizes that parties' concerns may be allayed if the CAISO provides further clarity in Section 11.5.7. Therefore, the CAISO agrees to clarify this section without changing the impact on the application of the perfect hedge to the HASP/RTM Congestion Charges.

2. Other Requests for Clarification or Rehearing for ETCs Should be Denied

The September 21 Order represented the culmination of a long stakeholder process that both preceded and followed the CAISO's conceptual filing on ETCs. While certain parties continue to pursue long-standing issues, the Commission's determinations are well-founded and should be affirmed.

First, certain of the issues raised in the pleadings will be addressed in the compliance filing or other processes the Commission has already ordered. For example, Modesto and Cities/MSR state that the allocation of import capacity for Resource Adequacy purposes must not be allowed to diminish ETC rights and the technical conference on intertie capacity should result in full protection for ETC rights.[80] This issue will be fully vetted in the technical conference and the CAISO's subsequent compliance filing and should not be addressed on rehearing of the September 21 Order.

Six Cities argues on rehearing that the CAISO should notify Scheduling Coordinators of scheduling errors related to Converted Rights and permit an opportunity

[80] Modesto at 36. Cities/MSR at 47.

for correction.[81] The CAISO agrees that there should be no differential application of the perfect hedge between ETCs and Converted Rights (for the period that Converted Rights receive this treatment). As the Commission has already required the CAISO to specify a process whereby ETC holders would be notified of errors and permitted to correct them, the CAISO proposes in its compliance filing to make this language generally applicable to any entity that is receiving the perfect hedge.[82]

Second, there are ETC issues that have been thoroughly and repeatedly considered and the parties have not offered grounds to revisit determinations. These include the treatment of transmission losses with respect to ETCs, nodal pricing for ETCs, use of ETCs for imports of Ancillary Services, and the requirement that New Participating TOs with Converted Rights submit balanced Schedules to receive the perfect hedge. Another example is the request of Burbank and Turlock that the Commission grant rehearing and limit the CAISO's authority to curtail ETCs under Section 16.5.1 in the event of a System Emergency.[83] As the September 21 Order correctly found, this provision was existing tariff language that pre-dated MRTU and no reason has been given as to why this authority – a necessary provision for any grid operator - has become unjust and unreasonable.[84]

Third, parties continue to misinterpret the MRTU Tariff as affecting rights under their existing agreements.[85] If the contracts do not have rate change rights, then the ETC holder will continue to pay in accordance with the agreement and any cost

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81 Six Cities at 26-27.
82 September 21 Order at P 920.
83 Burbank/Turlock at 13-18.
84 September 21 Order at P 963.
85 For example, IID seeks clarification that it will continue to be able to settle transmission losses through its existing contract, which allows the parties either to pay for average losses or to self-supply losses. IID at 56-59.

differential will be recovered under the Participating TO's Transmission Revenue Balancing Account. If the contract does permit rate changes, then the Participating TO would have to file with the Commission to implement any pass through charges, which would have to be just and reasonable.

The Commission's determinations with respect to the CAISO's ETC proposal for MRTU are well supported and provide an improved basis for honoring ETC rights while improving the efficiency of market operations. Accordingly, the September 21 Order's findings as to Section 16 and the other provisions related to ETCs should be affirmed.

3. Resale of Unscheduled TOR Capacity

In the September 21 Order, the Commission found that the CAISO's treatment of Transmission Ownership Rights ("TORs") was "generally reasonable, but require further clarification and modification."[86] The CAISO will be providing this additional specificity in its compliance filing. One issue the CAISO does want to address is the issue of resale of unscheduled TOR capacity. MWD requests rehearing to the extent the order allows the CAISO to sell unscheduled TOR capacity without the consent of the owner.[87] The CAISO clarifies that it does not and does not intend to resell this capacity. It will be reserved for the use of the TOR holder.

[86] September 21 Order at P 987.
[87] MWD at 9-11.

O. Resource Adequacy Issues

1. The Commission Acted Appropriately and Pursuant To Its Authority in Applying a Balanced Jurisdictional Approach to the CAISO Resource Adequacy Proposal

Recognizing the "confluence of state-federal jurisdiction,"[88] the September 21 Order adopts a balanced approach in its consideration of the CAISO's Resource Adequacy ("RA") proposal. The Commission requires that all LSEs accept, as a condition of participation in the CAISO Markets and use of the CAISO Controlled Grid, the minimum RA obligations imposed under the CAISO Tariff, but defers to the CPUC and other Local Regulatory Authorities to establish appropriate Planning Reserve Margins for LSEs under their respective jurisdictions.[89]

Notwithstanding the deliberate balance struck by the September 21 Order, certain parties continue to contest the Commission's basis for asserting jurisdiction over RA. The CPUC contends that the Commission's description of its jurisdiction appears to overstate its statutory authority and historic jurisdiction over areas of state control.[90] Several municipal entities protest the Commission's determination that the RA requirements should apply to all LSEs and contend that the Commission's grounds for asserting jurisdiction over RA are flawed.[91] They question the Commission's rationale that the interconnected grid makes everyone's resources interdependent, that RA programs are necessary to encourage construction of generation, and that it is

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88 September 21 Order at P 1112.

89 September 21 Order at P 1116 and P 1118.

90 CPUC at 4-13. More specifically, the CPUC asserts that: (1) under the FPA, jurisdiction over integrated resource planning and energy portfolio standards is reserved to the states and (2) while system operators play a key role in assessing the effects of existing and planned facilities on loop flows and system reliability, the responsibility for determining an appropriate reserve margin, level of long-term reliability, and economic enhancements appropriate for the state lies primarily on the state's shoulders. CPUC at 4, 6-7.

91 Modesto at 32-37; Cities/M-S-R at 42-47; Bay Area at 44-56; Lassen at 38-44.

appropriate to condition access to the CAISO Controlled Grid on adherence to the RA provisions of the tariff.[92]

The CAISO will not reiterate the arguments it has previously made regarding the Commission's authority to approve the RA program as a condition of service.[93] It is sufficient simply to underscore, as the Commission recognized, that the CAISO cannot efficiently conduct market operations and ensure grid reliability without a committed source of supply. All parties recognize this need, which the CAISO and the Commission have sought to meet with substantial deference to the determinations of the CPUC and Local Regulatory Authorities over long-term resource planning and service reliability. Amazingly, none of the parties who continue to protest the Commission's authority to approve Section 40 discuss the fact that all of the other RTO or ISO operating organized markets have Commission-approved RA requirements. The absence of any attempt to distinguish California concedes an inability to do so. For thirty years, the Commission and the Courts have accepted the imposition of capacity obligations imposed on LSEs participating in power pools.[94] The Courts also have endorsed universally-applicable RA programs for other markets. In *Sithe New England Holdings, LLC v. FERC*, for example, the First Circuit noted with respect to ISO New England's Installed Capacity ("ICAP") charge:

> The ICAP charge …is a payment to suppliers over and above the amount they charge for power sold to or reserved for buyers. Its aim is not private compensation for past investment; Instead, it is designed to serve two

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92 *See, e.g.*, Bay Area at 45; Cites/MSR at 42; Lassen at 39-40.

93 "*See, e.g.*, "California Independent System Operator Corporation Electric Tariff Filing to Reflect Market Redesign and Technology Upgrade," Docket No. ER06-615-000 at 59-71 (Feb. 9, 2006) ("CAISO MRTU Transmittal Letter"); Reply Comments of the California Independent System Operator Corporation," Docket No. ER06-615-000 at 177-192 (May 16, 2006) ("CAISO MRTU Reply Comments"); "Answer to Reply Comments of the California Independent System Operator Corporation," Docket No. ER06-615-000 at 20-36 (June 2, 2006) ("CAISO MRTU Answer to Reply Comments").

94 New England Power Pool Agreement, 56 FPC 1562 (1976).

> different public purposes: one is to give providers an extra incentive to construct new plants and the other – this time the stick rather than the carrot …-- is to impose a hefty penalty on those buyers who fail to acquire the reserve capacity that FERC has decreed they shall have.[95]

Similarly, in *Electricity Consumers Resource Counsel v. FERC*, the Court of Appeals for the District of Columbia Circuit noted with respect to the New York ISO's ICAP rate:

> Because we conclude that the rate design …seeks to stabilize rates to promote the development and retention of installed capacity, there is no basis for applying a heightened standard of review …we conclude that the Commission's approval of the rate design is supported by substantial evidence in the record and is not otherwise arbitrary and capricious.[96]

The CAISO has not sought imposition of an ICAP charge to enforce its RA obligation, relying instead on the commitments of Local Regulatory Authorities to oversee LSEs under their jurisdiction. The Commission too has been more deferential to Local Regulatory Authorities in California. Whereas in New York, the Commission-approved New York State Reliability Counsel establishes the planning reserve margin (currently 118% of peak load), the Commission rejected the CAISO's attempt to impose a 115% minimum standard and required the CAISO to utilize whatever planning reserve margin is approved by the Local Regulatory Authority. Nevertheless, the CAISO -- as does PJM, ISO New England, the New York ISO and the Midwest ISO -- must have confidence that resources will be available when and where needed to serve Demand. The Commission was correct in stating as far back as 2003 that RA was "a critical element to any market design."[97]

Certain parties contest the Commission's agreement to make compliance with Section 40 a condition of service and argue that the Commission cannot "attempt to do

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[95] 308 F.3d 71 at 77 (1st Cir. 2002).

[96] 407 F.3d 1232 at 1233 (D.C. Cir. 2005).

[97] *Further Order on the California Comprehensive Market Design Proposal*, 105 FERC ¶ 61,140 at PP 205, 214 (2003).

indirectly what it is precluded from doing directly."[98] San Francisco, for example, contends there is a distinction between self-schedules and bids and that the Commission's authority for conditioning access to the CAISO Controlled Grid is less than its authority over the standards for participation in the CAISO's markets.[99]

San Francisco's argument is without merit. In Order No. 888, the Commission required non-public utility entities as a condition of access to transmission service to make reciprocal open access available over their own facilities.[100] When met with similar arguments as to the scope of its conditioning authority, the Commission responded:

> While we do not have full jurisdiction over non-public utilities our actions in regulating jurisdictional matters may impact those who wish to use jurisdictional services or enter into agreements with public utilities.

This is precisely the same approach that the September 21 Order takes in approving the CAISO's RA program. There is the recognition that RA is an essential element in preserving the just and reasonable rates in the CAISO markets and the security and reliability of the transmission grid under CAISO control – matters within the Commission's exclusive jurisdiction.

Modesto claims that a non-public utility's options with regard to open access transmission requirements under Order No. 888 are distinguishable from its options with regard to RA requirements under the MRTU Tariff because, under Order No. 888, the

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98 AEPCO/SWTC at 6; Bay Area at 48; Lassen at 42-44.

99 San Francisco at 7-8.

100 *See Promoting Wholesale Competition Through Open-Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs., Regulations Preambles January 1991-June 1996 ¶ 31,036 – 31,657 (1996), *on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,048 (1997), *on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

non-public utility was free to seek a waiver of the open access tariff reciprocity condition.[101] This argument, however, fails to withstand scrutiny. First, under Order No. 888, the Commission was requiring non-public utilities to undertake the affirmative obligation to serve third parties by providing equivalent open-access on their transmission system. In this case, the Commission is acting to prevent any party, including non-public utilities from potentially harming others by inappropriately leaning on the resources of others. Accordingly, the Commission's conditioning authority should be greater under MRTU. Moreover, even if the tariff does not specifically provide for a waiver, nothing would prevent Modesto or any other party from petitioning the Commission for a waiver if they felt the RA provisions produced unjust and unreasonable results as applied to them.[102]

Parties cite *Bonneville Power Administration v. FERC*[103] for the proposition that the commission lacks "subject matter" jurisdiction over non-jurisdictional resources.[104] This argument is also without merit. *Bonneville* only recognizes a limitation on the Commission's authority to impose a retroactive refund obligation on non-public utilities. The *Bonneville* Court noted that such an obligation may arise from contracts such as service agreements. More importantly, the *Bonneville* Court recognized,

> It would be one thing for FEC to order the CALPX and ISO to operate the market in a different fashion or to set a market-clearing price for power on a going forward basis, but the retroactive imposition of a market price that effects refund responsibility is a regulatory action that falls outside of

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101 Modesto at 35-36. *See also*, Bay Area at 49; Cities/MSR at 45-47; Lassen at 43.

102 For example, certain generators petitioned for exemptions form the Commission's must offer requirement. "Complaint of the Independent Energy Producers Association to Implement an Interim Reliability Capacity Services Tariff," Docket No. EL05-146-000 (Aug. 26, 2005) (alleging that the existing must-offer obligation under the CAISO tariff was flawed and no longer just and reasonable and requesting that FERC direct the CAISO to replace the existing must-offer obligation and related minimum load cost compensation tariff provisions with an interim set of tariff provisions).

103 422 F.3d 908 (9th Cir. 2005).

104 Modesto at 35; Bay Area at 46-47; Cities/MSR at 43; Lassen at 40-41.

> FERC's jurisdiction with respect to non-public utilities and governmental entities.[105]

In conditionally approving the MRTU RA provisions, the Commission is acting in a prospective manner – approving a new market design to replace one that has been found to produce unjust and unreasonable results. The better precedent is that noted above with respect to the court's approval of capacity obligations being imposed on LSEs in other markets.

The CPUC also argues that the September 21 Order leaves unclear the limits of FERC jurisdiction to authorize the CAISO to engage in procurement in order to meet NERC/WECC reliability standards, and the MRTU Tariff does not reveal what methods the CAISO will use to set its reliability standard.[106] Accordingly, the CPUC requests clarification, or in the alternative rehearing, that FERC's conditional approval of the MRTU Tariff is not intended to impinge upon California's authority to determine what level of reliability appropriately balances reliability and costs.[107] The CPUC also requests clarification that: (1) FERC does not intend to interfere with the state's jurisdiction to develop and integrate demand response programs in the process of planning for RA; and (2) that the CAISO's interpretation of its AB 1890 and NERC/WECC reliability criteria should respect both the state's and the CPUC's jurisdiction to select priority of resources to be used to support grid reliability, and the cost to be paid for that reliability.[108] While the CAISO understands the importance of these concerns to the CPUC, they were appropriately addressed in the September 21Order and no further action is necessary.

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105 422 F.3d 908 at 920 (9th Cir. 2005).
106 CPUC at 8.
107 CPUC at 8.
108 CPUC at 8-13.

The Commission has already directed the CAISO to incorporate into the tariff the reliability criteria it will use in developing Local Capacity Area resource requirements and to address the need for transparency and justification of backstop procurement of Local Capacity Area Resources by placing safeguards in the MRTU Tariff. [109] The CAISO's compliance filing will provide the additional assurance and transparency requested by the CPUC. Moreover, the approved tariff provisions already defer to the CPUC and other Local Regulatory Authorities with respect to Demand response.[110]

2. The Commission Appropriately Found That All LSEs That Serve Load in the CAISO Control Area and All Entities with Loads in the CAISO Control Area Must Comply With RA Requirements as a Condition for Participating in the CAISO Market

In the September 21 Order, the Commission appropriately determined that all LSEs that serve load in the CAISO control area must comply with RA requirements as a condition for participating in the CAISO Market and utilizing the CAISO Controlled Grid. This conclusion was based on a finding that,

> [w]here an interconnected transmission system is operated on a regional basis as part of an organized market for electricity, as in California, all users of the system are interdependent, particularly with respect to reliability, i.e. one participant's reliability decisions can impact the reliability of service available to other participants and the related costs that they must bear.[111]

Golden State Water Company ("GSW") requests that the Commission clarify that GSW had not argued for an exemption from the CAISO RA requirements, but rather argued that the Commission should provide GSW and the CAISO with the flexibility to

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109 September 21 Order at P 1167 and P 1192.
110 MRTU Tariff at § 40.4.1 (designation of eligible resources).
111 September 21 Order at P 1113.

address GSW's circumstances once the CPUC has acted in its pending rulemaking.[112] GSW asks that the Commission require the CAISO to amend the MRTU Tariff as necessary to reflect the final outcome of the pending CPUC rulemaking proceeding on RA requirements for smaller investor owned utilities under CPUC jurisdiction.[113] GSW's requests are unnecessary. As modified by the Commission, Section 40.2 already defers to the Reserve Margin established by the CPUC or other Local Regulatory Authority. Thus, if the CPUC establishes different requirements for GSW or other smaller LSEs under its jurisdiction, that determination will automatically be reflected under the MRTU Tariff.

However, the CAISO believes the Commission should clarify application of a default reserve margin to GSW and similarly situated CPUC jurisdictional LSEs. The September 21 Order found that in the absence of action by a "Local Regulatory Authority" to establish a reserve margin, the CAISO could impose a default reserve margin on the relevant LSE.[114] The Commission did not indicate whether a default reserve margin should apply if the CPUC fails to establish an applicable reserve margin. The CPUC, in fact, has not adopted rules covering its small LSEs, such as GSW. If the CPUC has not acted by the MRTU implementation date, uniformity of treatment among state regulatory entities would militate in favor of applying the default reserve margin to uncovered CPUC jurisdictional LSEs.

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112 GSW at 13.
113 GSW at 13-16.
114 September 21 Order at 1153-1154.

3. The Commission Appropriately Found that the CAISO's Criteria for Determination of Local Area Capacity Responsibility Is Reasonable

a. The CAISO Should Be the Entity To Assess the Local Requirements Related To Meeting Reliability Criteria

Cities/M-S-R maintain that the Commission erred by infringing on the authority of Local Regulatory Authorities to set their own requirements for Local Capacity Area Resources.[115] SVP argues that the Commission erred in rejecting SVP's arguments that load-following MSSs should be exempt from local RA requirements because load-following MSSs are obligated to meet their load under the threat of severe deviation penalties resulting from non-deliverable resources, thus there is no need for the CAISO to determine the appropriate Local Capacity Area Resources.[116] In addition, SVP states that the Commission erred by failing to recognize the double charge for local RA requirements and deviation penalties for MSSs.[117] These arguments should be rejected and the Commission should reaffirm its determination that "the CAISO is uniquely situated to assess capacity needs in constrained areas and load pockets,"[118] and that all entities, including MSSs, should meet their fair share of Local Area Capacity requirements.[119]

The Commission correctly found that the CAISO is the entity best suited to determine Local Area Capacity requirements. The CAISO is obligated under state and federal mandates as well as contractually under the Transmission Control Agreement to

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115 Cities/M-S-R at 41-42. See also, Bay Area at 44 and Lassen at 39. Similarly, Six Cities argues that the Commission's uncritical acceptance of the CAISO's RA proposal is inconsistent with its duty to ensure that the CAISO does not unnecessarily override determinations by LRAs on the use of resources and implementation of RA Plans. Six Cities at 6-8.

116 SVP at 63-64.

117 SVP at 63-64.

118 September 21 Order at 1119.

119 *Id.* at 1168.

operate the CAISO Control Grid in accordance with Good Utility Practice and Applicable Reliability Criteria, including Local Reliability Criteria established prior to CAISO operations.[120] Discharging this responsibility effectively and efficiently requires the ability to comprehensively assess the physical characteristics and operation of the entire CAISO Controlled Grid. In this regard, the CAISO has the expertise to perform the planning studies necessary to determine the Local Area Capacity requirements. The CAISO performed the study identifying requirements for 2006 and has undertaken similar analyses since its inception with respect to the Local Area Reliability Services process for RMR procurement. It follows that if the CAISO has the authority to engage directly in procurement of RMR generation to meet locational needs, the CAISO should have the authority to establish minimum locational criteria for LSEs who then will be responsible to procure the necessary resources. The LSEs are in a better position to determine the least cost approach to meeting the Applicable Reliability Criteria as they can engage in programs involving construction of facilities, encouragement of Demand response, or long-term contracting. Thus, the September 21 Order correctly finds that the identification and assignment of Local Area Capacity by a single entity will best guarantee both compliance with Applicable Reliability Criteria and an equitable sharing of the responsibility to ensure capacity is available where needed. MSSs, similar to any other LSE, must bear their fair share of the responsibility for Local Area Capacity. It is irrelevant that MSS Operators are subjected to a penalty if there is an imbalance between the MSSs supply and Demand in Real-Time or that MSS Operators have greater control over their scheduling and unit operations. The Local Area Capacity requirements serve a different purpose. As noted above, Local Area Capacity

[120] *See,* Transmission Control Agreement at Sections 5.1.3 and 5.1.5.

requirements arise due to existing transmission constraints that prohibit the CAISO from meeting Applicable Reliability Criteria without a minimum quantity of locational capacity within the local area. Thus, all LSEs have a proportionate obligation to provide the necessary capacity to the CAISO. The fact that MSS entities also have a load serving obligation does not obviate the need for capacity located within these load pockets. Further, the reliable operation of the integrated system requires that the CAISO have dispatchable capacity that may be called upon to resolve unique transmission configurations, for example a scheduled outage of a major transformer or line. MSS entities cannot readily foresee nor economically schedule resources to meet the necessary reliability needs under such circumstances. Accordingly, the MSS structure does not substitute for the Local Area Capacity obligation.

b. The CAISO's Reliability Criteria Is Reasonable

Some parties argue that the Commission erred in accepting N-1-1 reliability criteria for determining local resource adequacy capacity requirements.[121] Six Cites contends that, rather than the N-1-1 criteria, the Commission should find that NERC reliability standards constitute the appropriate reliability criteria and that, at a minimum, the CAISO should file the proposed methodology for developing local capacity area resources.[122] Modesto and Bay Area argue that the record does not reflect the CAISO's contractual obligations with Participating Transmission Owners and that these should be identified otherwise the Commission's decision is "unsupported and deficient."[123]

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[121] Modesto at 37. Six Cities at 16-18. SVP and Bay Area state the Commission's decision to accept N-1-1 reliability criteria for determining local resource adequacy capacity requirements was not supported by the record. SVP at 70; Bay Area at 55

[122] Six Cities at 16-18.

[123] Modesto at 37; Bay Area at 55.

As noted above, the Commission has already directed the CAISO to incorporate into the tariff the reliability criteria it will use in developing Local Capacity Area resource requirements and the CAISO will be doing so in its compliance filing.[124] Nevertheless, the CAISO has recognized that the Applicable Regulatory Criteria can be satisfied by different approaches, including curtailment of load, and it is appropriate for the Local Regulatory Authority to determine the level of service reliability. Accordingly, in its compliance filing, the CAISO will propose that in performing its study, the CAISO will defer to the level of service reliability determined by the applicable Participating Transmission Owner and applicable Local Regulatory Authority.

4. The September 21 Order Appropriately Balanced the Roles of Various Parties in Determining Qualifying Capacity for RA Resources

a. The Commission Properly Found that the CAISO Should Make Net Qualifying Criteria Determinations

In the September 21 Order, the Commission concluded that "the CAISO is best positioned to make uniform and nondiscriminatory determinations of net qualifying capacity through its assessment of deliverability, performance and testing."[125] San Francisco challenges this determination stating, 'there is no statutory provision that authorizes the CAISO discretion to, in effect derate a resource"[126] San Francisco's rehearing request should be rejected.

San Francisco's contention is just a further challenge to the Commission's authority to approve the RA provisions of the MRTU Tariff. The CAISO is responsible for ensuring the reliability of the grid. This responsibility can only be satisfied if

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124 MRTU Order at P 1169.
125 September 21 Order at P 1213.
126 San Francisco at 6.

resources are actually available, e.g., deliverable and capable of producing its assumed output. While certain variations in RA programs among the CPUC and Local Regulatory Authorities and LSEs under their respective jurisdictions are acceptable, there must be some uniform criteria and minimum standards. The CAISO is not attempting to usurp the authority of state regulatory entities, but rather to simply ensure fairness and prevent unintended cost shifting. The CAISO's determination of Net-Qualifying Capacity is consistent with this objective as well as its role to ensure non-discriminatory and non-preferential terms of service. The CAISO currently makes similar determinations, for example, by testing units to establish "Pmax" values and the ability to supply Ancillary Services. The CAISO is unaware that this testing, which also applies to units operated by non-jurisdictional utilities, has been a source of contention or controversy. If San Francisco concludes that the CAISO has inappropriately derated a resource, it has access to the dispute resolution provisions of the CAISO Tariff.

b. Allocation of Import Capacity

The Commission granted the CAISO's request to conduct a technical conference to develop an equitable methodology for allocating RA import capacity.[127] Bay Area and Lassen argue that the allocation of import capacity must not be permitted to diminish existing contract rights, and they request clarification that any allocation of import capacity resulting from the technical conference must fully protect existing contract rights.[128] AEPCO/SWTC requests that the full 10 MW of the Anza ETC be utilized to satisfy any RA requirements imposed on Anza.[129] Several parties argue that the

[127] September 21 Order at P 1226.
[128] Bay Area at 56; Lassen at 44.
[129] AEPCO/SWTC at 7.

Commission erred in failing to allow System Resources accessed through ETCs and TORs to qualify as RA Resources and meet local capacity requirements.[130]

As indicated by the clarification and rehearing requests, parties have strong views regarding the issue of allocation of import capacity. The CAISO believes that it would be premature to consider these pleadings at this time. The Commission should permit all parties, including those that have sought clarification or rehearing, to participate at the technical conference. Based on this additional record, the revised CAISO submission, and any additional opportunity for comments, the Commission will be better positioned to make a determination on these issues.

The September 21 Order did reiterate a finding from the order on the CAISO's Interim Reliability Requirements Program that allocation of import capacity for RA purposes does not degrade the benefits of existing FTRs held by new PTOs.[131] Vernon and Six Cities seek reversal of this conclusion.[132] They state that the Commission inappropriately dismissed comments on this issue and, thus, may not authorize the expropriation of the capacity value of the New PTOs' FTR rights absent a rational explanation.[133] The parties propose that New PTOs holding FTRs be allocated import capacity for RA purposes up to the limit of their FTR rights for the purpose of procuring additional resources.[134]

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130 MWD at 2-6; Bay Area at 56; Lassen at 44; San Francisco at 3-6. *See also* Cities/MSR at 48 and MWD at 5-6. SWP also argues that the MRTU Order failed to consider firm ETC transmission as firm transmission for purposes of resource adequacy. SWP argues that transmission capacity entitlements under an ETC should be credited for purposes of meeting the needs of local reliability areas or system requirements involving an import. SWP at 51..

131 September 21 Order at P 1227.

132 Vernon at 3-4; Six Cities at 8-12.

133 Vernon at 4; Six Cities at 11.

134 Vernon at 4; Six Cities at 11-12.

The CAISO believes the September 21 Order correctly found that allocation of import capacity for RA purposes does not degrade the benefits of existing FTRs held by new PTOs. Nevertheless, the CAISO also believes that a comprehensive review of the import allocation methodology at the technical conference is appropriate, including issues regarding the potential interrelationship between FTRs and RA.

5. The Commission Should Reaffirm the Reasonableness of the CAISO's Availability Requirements

a. Six Cities' Request Should Be Denied

Six Cities argues that the Day-ahead scheduling and bidding requirements imposed on Modified Reserve Sharing LSEs "will eliminate the ability of Modified Reserve Sharing LSEs to manage their resources internally and unreasonably interfere with LSE's resource procurement and utilization policies."[135] Six Cities argues that the CAISO should implement a mechanism to identify the Local Capacity Area Resources that are needed rather than impose a rigid must-offer requirement.[136] Further, Six Cities states that RA System Resources not committed in the Day-Ahead IFM or RUC should not have a Real-Time availability obligation.[137] Six Cities' requests should be denied.

The CAISO's RA program does not interfere with the Six Cites' ability to manage their resources. It is up to the Six Cities to develop a resource adequacy plan and to bid the resources in accordance with the plan. The CAISO has noted previously in its comments that if as Local Regulatory Authorities, the Six Cities choose to elect Modified

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135 Six Cities at 12-13.
136 Six Cities at 12-14.
137 Six Cities at 12-14.

Reserve Sharing LSE status, they may implement a program in which the Reserve Margin is determined based on a load duration curve.[138]

The Six Cities appear to mix different concepts – procurement of resources for RA purposes and selection of resources in the Day-Ahead or Real-Time Markets to meet system needs. The RA Planning Reserve Margin is meant to have a contingency factor to account for forced outages or unusual system or weather conditions. In contrast, when the CAISO runs the Day-Ahead Market it is taking a shorter-term look at system conditions and selecting only those units necessary to meet the anticipated Demand and Ancillary Service requirements for the upcoming period. Long-Start units, not otherwise scheduled by the Reserve Sharing or Modified Reserve Sharing LSE, and not selected in the Day-Ahead Market have no further RA availability obligation. The obligation of Short Start units is different depending on whether the LSE has elected Reserve Sharing on Modified Reserve Sharing status. For Reserve Sharing LSEs, Short Start units providing Resource Adequacy Capacity must bid any unused capacity into the Real-Time market so that the CAISO has sufficient resources to meet changes in system conditions from those anticipated the pervious day. For Modified Reserve Sharing LSEs, a Short Start unit that does not clear the IFM or committed in RUC has no further obligation to the CAISO, except under System Emergencies.[139] Accordingly, the Short Start unit remains available to the Modified Reserve Sharing LSE to satisfies its requirement to maintain the quantity of capacity committed during the Day-Ahead Market. Thus, the CAISO's RA program is not rigid and inflexible as suggested by Six Cities, but a reasonable approach to meeting the anticipated and actual Demand on the

[138] CAISO MRTU Reply Comments at 217-218 (explaining that Section 40.5.2 does not prevent the use of load duration curves).

[139] See MRTU Tariff at § 40.5.2(2).

CAISO Controlled Grid based on the operating characteristics of the units, the procurement practices of the LSEs, and the Planning reserve Margins established by the Local Regulatory Authorities.

b. The Commission Should Reaffirm Its Acceptance of the Provisions With Respect To Use-Limited Resources

In the September 21 Order, the Commission rejected PG&E's request to exempt hydroelectric use-limited resources from the availability requirements.[140] The Commission noted that the MRTU Tariff permits the Scheduling Coordinator to retain control of the resource by submitting a plan specifying how the resource is to be dispatched by the CAISO.[141] In its clarification and rehearing request, PG&E states that preordained constraints by the CAISO could prevent hydroelectric unit operators from responding appropriately to the complex requirements to which their resources are subject.[142] Additionally, PG&E asserts that, while the MRTU Tariff provides a certain degree of flexibility to the scheduling and dispatch of hydroelectric units, it requires Scheduling Coordinators to submit annual and monthly use plans which may or may not be sufficient to accommodate the inherent characteristics of these facilities. As a result, PG&E contends that the CAISO should be required to clarify how it will evaluate and enforce compliance with these tariff provisions, and to what extent the CAISO will allow updates to the use plans after the monthly updates.[143]

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[140] September 21 Order at P. 1309.

[141] September 21 Order at P 1307.

[142] PG&E at 8-10. San Francisco also argues that the MRTU Order exceeds FERC's authority by applying real-time availability provisions to the use-limited RA resources of non-jurisdictional entities, including hydro, and resources with environmental dispatch restrictions. San Francisco suggests instead that, if the CAISO needs non-jurisdictional, use-limited resources to dispatch in real-time, it should (1) negotiate agreements that appropriately balance the CAISO's reliability needs with the non-jurisdictional resource's operational and statutory restrictions and (2) compensate the entity providing dispatch to the CAISO. San Francisco at 8-10.

[143] PG&E at 8-10.

At this time, the CAISO believes that the monthly use plans submitted by LSEs such as PG&E should afford reasonable opportunities to control the usage of hydroelectric and other Use-Limited resources. If this approach proves problematic, the CAISO would work with stakeholders to develop a means to revise the use plan between the monthly submissions.

Six Cities requests that use-limited resources not be subject to a Must-Offer requirement.[144] Such an action would mean that while resources would be given credit for serving actual load, they would have not corresponding obligation to actually be available to the CAISO to serve Demand. If Six Cities are concerned that their use-limited resources be available for summer peak periods,[145] Six Cities can protect itself by submitting a plan that designates this period as being the time in which it will be making the use-limited resource available for dispatch. If resources are going to be given credit for meeting RA requirements, they must be available to the CAISO to serve Demand. Otherwise the system reliability the RA program is designed to meet will be impaired.

c. The Order Appropriately Found that the CAISO Will NOT Improperly Curtail Exports

The September 21 Order found that "[t]he resource adequacy proposal in the MRTU Tariff does not change Imperial or anyone else's ability to enter into agreements with resources within the CAISO Control Area, nor does it change their ability to schedule those resources as exports out of the CAISO Control Area."[146] Burbank/Turlock argue that the Commission erred in allowing the CAISO to have real-

144 Six Cities at 14-15.
145 Six Cities at 16.
146 September 21 Order at P 1285.

time authority to curtail exports of a RA Resource alleging it will hinder the effective functioning of exports.[147] IID continues to contend that the RA proposal discriminates against exports generally. To that end, IID requests clarification that, if IID co-owns a RA Resource or enters into a firm contract with an RA Resource, then the capacity designated to serve IID will not be curtailed under Section 40.6.11 because such generation will be excluded from the definition of Resource Adequacy Capacity.[148] IID also requests clarification as to how the generation capacity will be designated if there is a derate in a generator.[149] Finally, IID argues that FERC should require that the CAISO be consistent with WECC guidelines (1) where firm exports are only cut during an emergency and after all non-firm schedules have been curtailed and (2) in terms of percentage levels that operating reserves would have to reach in order to declare an emergency and cut load.[150]

While IID and Burbank/Turlock want to protect all exports from curtailment, it is important to distinguish two types of sales. The first are sales from a unit located in the CAISO Control Area for all or part of the capacity of the unit *that is not under a RA obligation to the CAISO*. In this case, the CAISO agrees with IID that the export would not be subject to curtailment under Section 40.6.11 as it is not Resource Adequacy Capacity. To the extent Section 40.6.11 refers to curtailment of a Resource Adequacy Resource, rather than Resource Adequacy Capacity, the CAISO intends to correct this inadvertent error in its upcoming compliance filing. There is, however, a second case. Section 40.6.10 permits Exports of Energy being provided by Resource Adequacy

147 Burbank/Turlock at 11.
148 IID at 14-18
149 IID at 14-18
150 IID at 28-32.

Capacity. These are non-firm sales from Resource Adequacy Resources that would be subject to curtailment under Section 40.6.11 if necessary to prevent or alleviate a System Emergency. This interruption is appropriate as the Capacity from which the economy Energy is being sold has already be paid-for and committed to the CAISO by LSEs in the CAISO Control Area. Other RTOs and ISOs have similar rights to curtail sales from Resource Resources.[151] The importance of this recallable right was explained by the PJM Market Monitoring Unit as follows:

> Capacity obligations have played a critical role in maintaining grid reliability and in contributing to the effective, competitive operation of the energy market in PJM. Load Serving Entities (LSEs) in PJM are required to acquire capacity resources equal to their load obligations including a reserve margin. Adequate capacity resources, as defined by the OA and Reliability Assurance Agreement Among Load Serving Entities in the PJM Control Area (RAA), provide the assurance that energy will be available to loads in PJM on even the highest load days. A critical link between capacity obligations and reliability is that generation owners sell a recall right to the energy from their generation when they sell capacity resources. This enables PJM to recall energy exports from capacity resources when PJM invokes Emergency procedures. The recall right establishes the link between capacity and the actual delivery of energy when it is needed.[152]

With respect to de-rates, the CAISO would expect that the reduction would be spread pro-rata based on a party's entitlement to the Capacity of the unit. If parties have reached a different agreement with respect to de-rates, the CAISO would expect that information to be provided by the relevant Scheduling Coordinators.

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[151] See for example, Section 5.12.10 of the New York ISOs Market Services Tariff which provides:

> All Unforced Capacity that is not out of service, or scheduled to serve the Internal NYCA Load in the Day-Ahead Market may be scheduled to supply Energy for use in External Transactions provided, however, that such External Transactions shall be subject to Curtailment within the hour, consistent with ISO Procedures. Such Curtailment shall not exceed the Installed Capacity Equivalent committed to the NYCA.

[152] Market Monitoring Unit PJM Interconnection, L.L.C., Report To The Federal Energy Regulatory Commission Enforcement Remedies, April 1, 2001, http://www.pjm.com/markets/market-monitor/downloads/mmu-reports/20010402-mmu-enforcement-report.pdf

As to the issue of when the CAISO would need to curtail exports of Energy from Resource Adequacy Resources, the CAISO supports the Commission's determination that "Section 40.6.11 clearly states that the CAISO may only curtail to "prevent or alleviate a System Emergency.""[153] This terminology has been accepted elsewhere in the tariff and no further detail or clarification is necessary.

6. The Commission Appropriately Accepted the CAISO's Method for Allocating Costs of Backstop Procurement for Local Capacity

a. The September 21 Order Appropriately Allocates Certain Residual Costs To Exports and Wheel-Throughs

In the September 21 Order, the Commission rejected arguments by Modesto and SVP that backstop procurement costs should not be allocated to MSSs, exports and wheel-throughs.[154] Modesto continues to pursue the issue in its rehearing request, claiming that the Commission's determination stretches too far the principle of cost causation and that entities that are outside the CAISO Control Area are paying for reliability twice – once to their own control area and once to the CAISO. Modesto's argument is misplaced. As the Commission stated in the September 21 Order, the only backstop procurement costs being allocated to system demand (including Exports) are costs "in excess of a LSE's deficiency, which should be minimal."[155] To the extent that the CAISO must incur backstop procurement costs for RA, these costs will be primarily allocated to any Scheduling Coordinator whose monthly or annual Resource Adequacy Plan is deficient. The Commission is correct that any residual costs that the CAISO has incurred should be assigned to all users of the CAISO Controlled Grid. Wheel-throughs

153 September 21 Order at P 1285.
154 September 21 Order at P. 1197.
155 MRTU Order at P 1197.

and Exports from the CAISO Control Area benefit from the stability and reliability of the grid. Contrary to Modesto's assertion, this is not a situation where "[e]very single aspect of the CAISO-Controlled Grid could be argued to benefit everyone as far wide as the Western Interconnection."[156] Rather, it is a reasonable means of assigning what is anticipated to be a small amount of residual costs to those customers actually taking service over the CAISO's facilities.

b. The Commission Should Deny the Rehearing requests Concerning the Allocation of Local Area Capacity Resource Costs

SVP and Bay Area assert that the Commission erred in accepting the CAISO's method for allocating costs of backstop procurement for local capacity.[157] They state that the CAISO appears to be phasing out RMR contracts in favor of local "RA" contracts, which will shift the cost and responsibility from the PTOs to the LSEs" and contend that the Commission should have adopted SVP's proposal to use RMR-style allocation for backstop procurement costs.[158] Bay Area also contends that for both RMR and CAISO backstop procurement of Local Capacity Requirements "the objective is the need for local generation to support reliable operation of the grid" and "to correct a transmission deficiency which resulted in load pockets."[159]

The contentions by SVP and Bay Area are misplaced. The reduction in RMR contracts for northern California is the result of an effective RA program adopted by the CPUC. Thus, the necessary local capacity for northern California is being procured by PG&E and other CPUC-jurisdictional LSEs serving load in northern California. The

156 Modesto at 38.
157 SVP at 66-70; Bay Area at 50-55.
158 SVP at 66-70; Bay Area at 50-55.
159 Bay Area at 52.

CAISO has not entered into any contracts for backstop Local Area Capacity. Indeed, SVP and Bay Area fail to recognize that the CAISO hopes it will not have to engage in any backstop procurement.

The CAISO is now being criticized on both sides. Earlier, the CPUC was concerned that the CAISO would engage in too much backstop procurement of Local Area Capacity, and now SVP and Bay Area appear to indicate that this procurement should be the sole responsibility of the CAISO similar to RMR. The CAISO submits that the MRTU Tariff as approved by the Commission sets an appropriate balance. The Local Regulatory Authority set the overall level for the Reserve Margin and service reliability. The CAISO analyzes the necessary Local Area Capacity requirements to meet Applicable Reliability Criteria and assesses the deliverability of resources. The applicable LSEs are responsible for supplying a portfolio of resources to meet these requirements.

P. Outage Scheduling Issues

Southern California Edison ("SCE") and the Western Area Power Administration ("WAPA") submit requests for rehearing and clarification concerning the transmission outage scheduling proposal accepted by the Commission.[160] The Commission accepted a CAISO proposal from its Reply Comments designed to address concerns with the CAISO's original proposal to require 45 days advance notice for *all* transmission maintenance outages under MRTU.[161] It appears that both SCE and

[160] September 21 Order at PP 1333, 1335.
[161] CAISO Reply Comments at 289-291.

WAPA misunderstand the CAISO proposal accepted by the Commission. The CAISO offers the following clarification.

The CAISO's proposal consists of three parts: (1) The CAISO no longer sought 45 days' advance notice for all transmission maintenance outages. Schedules for transmission outages that would *not* be expected to have a "significant impact on CRR revenue adequacy" (as determined based on criteria to be developed with stakeholder input) would continue to be due 72 hours in advance, as they are under the current CAISO Tariff. (2) For "significant" transmission maintenance outages, the advance notice requirement would be 30 days in advance of the first day of the month when the outage is scheduled. Depending upon when in the month the Participating TO plans to begin such an outage, this could translate to a deadline of 30 to 60 days in advance of the planned start date of such "significant" transmission maintenance outages. As the CAISO explained in its Reply Comments, this deadline is consistent with the deadline for scheduling "significant outages" in PJM. As in PJM, this deadline will provide needed information for the monthly release of congestion rights (*i.e.,* CRRs). (3) The CAISO clarified that this approach would not prevent modifications to scheduled outages because, under the MRTU Tariff, Participating TOs will retain flexibility to modify scheduled transmission maintenance outages after the applicable notification deadline.

SCE suggests that the CAISO's proposal will apply a 30 to 60 day scheduling deadline on all transmission maintenance outages, dismissing without justification the element of the CAISO's proposal applying the current 72 hour deadline to all outages

except those that will have a "significant impact on CRR revenue adequacy."[162] SCE also suggests that the CAISO proposal accepted by the Commission is unacceptable because it will protect a market function without due regard for preserving the reliability of the California transmission grid. This argument ignores the fact that PJM currently requires transmission owners to schedule significant transmission outages 30 days in advance of the first day of the applicable month without adverse impacts on reliability.[163] SCE's rehearing request on this issue should be denied.

WAPA incorrectly suggests that "the CAISO's proposal was to reduce the notice requirement from 45 days to 30 days" and requests that the Commission require modifications consistent with this understanding.[164] As discussed above, and as the Commission correctly stated in Paragraph 1333 of the September 21 Order, the CAISO's proposal was actually to apply an advance notice requirement for significant outages of "30 days in advance of the first day of the month when the outage is scheduled." There is no basis for WAPA's requested clarification.

WAPA also seeks rehearing on a related issue. WAPA incorrectly claims that the MRTU Tariff fails to include language from the current CAISO Tariff providing compensation for the direct and verifiable costs resulting from the CAISO's cancellation of an Approved Maintenance Outage.[165] WAPA requests that the Commission require the CAISO to reinstate this language. As the CAISO explained in its Reply Comments in this proceeding, however, Section 9.3.7.3 of the MRTU Tariff already contains the

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162 SCE Rehearing Request at 6-10.
163 *See* Section 1.9.2(c) of the PJM Operating Agreement.
164 WAPA Rehearing Request at 4-5.
165 WAPA Rehearing Request at 5-6.

anguage requested by WAPA.[166] Indeed, as WAPA recognizes, this is the same section where this language resides in the current CAISO Tariff.

Q. The Commission's Approval of the CAISO's Surplus Marginal Loss Revenue Allocation Methodology is Just and Reasonable, However, the CAISO Agrees That Further Study of this Issue is Warranted

PG&E reiterates concerns about the methodology approved in the September 21 Order for refunding the over-collection of Marginal Loss revenues.[167] PG&E continues to claim that the approved methodology is unjust and unreasonable because it fails to ensure that differences within California in transmission losses will not lead to a distorted allocation of Marginal Loss surplus revenues. PG&E notes that the CAISO has formed a stakeholder group to study the issue, and claims that the initial results appear to show that there is a sound basis for an allocation of the overcollection that is more consistent with cost-causation principles than the methodology approved in the September 21 Order adopts. PG&E requests that the Commission order the CAISO to complete this study and direct the CAISO to file revisions to its methodology for allocating surplus Marginal Loss revenues based on this study.

The CAISO commits to complete the study as outlined in the CAISO's "White Paper Framework for Study of Marginal Loss Surplus Allocation Impact" dated July 12, 2006 and the CAISO's "Progress Report on Regional Marginal Loss Surplus Allocation Impact Study" dated August 10, 2006, the latter of which was attached to PG&E's request for rehearing. This would entail using 12 months of LMP study results and following the methodology described in the referenced white papers without using the

166 CAISO Reply Comments at 291.
167 PG&E Rehearing Request at 4-7.

simplifications employed in determining the interim analysis results published as part of the August progress report. The CAISO also commits to sharing the results with stakeholders.

The CAISO does not agree that the study results alone should form the basis of a decision to change the allocation approach set forth in the CAISO's MRTU Tariff. Because the study uses simulated LMP data involving a number of assumptions, the results may not be representative of actual market outcomes. Accordingly, the CAISO intends to monitor actual market performance after implementation of MRTU and to conduct a further study based on actual data. These data will also be shared with stakeholders and will provide factual basis for the CAISO and its stakeholders to determine whether the CAISO should consider changing its filed allocation methodology.

The theoretical possibility that there are other approaches that might be considered to be more equitable is irrelevant to the consideration of whether the filed approach is just and reasonable. The allocation methodology for surplus Marginal Loss revenues set forth in Section 11.2.1.6 of the MRTU Tariff, which the Commission conditionally accepted in the September 21 Order at P 95, is supported by precedent. Like the CAISO's, the New York Independent System Operator 's ("NYISO") allocation approach also results in an even distribution of surplus marginal loss revenues to load in the NYISO control area without taking into account regional differences and without consideration of how much any individual market participant or group of market participants may have paid for losses.[168] The critical feature of the CAISO's and

[168] *See Central Hudson Gas & Electric Co., et al*., 86 FERC ¶ 61,062, *reh'g. denied*, 88 FERC ¶ 61,138 (1999).

NYISO's allocation approach is that it does not undermine or undo the benefits of marginal loss pricing. As reiterated by FERC in the September 21 Order, marginal loss pricing "sends more accurate price signals and assures least-cost dispatch."[169] The CAISO chose the filed allocation method for surplus revenues based on a number of criteria including preserving the marginal price signal, promoting investment in transmission to improve losses, and to provide better price signals for demand side participation in the CAISO markets. Accordingly, the Commission should reject PG&E's rehearing request insofar as asks the Commission to direct the CAISO to revise its surplus Marginal Losses revenue allocation.

[169] September 21 Order at P 90.

III. CONCLUSION

Wherefore, for the reasons discussed above, the CAISO respectfully requests that the Commission act on the requests for clarification and rehearing of the September 21 Order consistent with the discussion above.

Respectfully submitted,

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Dated: November 7, 2006

Certificate of Service

I hereby certify that I have this day served a copy of this document upon all parties listed 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 this 7th day of November, 2006 at Folsom in the State of California.

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