SANTA CLARA
CALIFORNIA

Santa Clara All-America City 2001

Electric Department
Silicon Valley Power

May 20, 2008

Mr. Yakout Mansour
Chief Executive Officer
California Independent System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95746

Re: California Independent System Operator, Inc. ("CAISO") Proposed Integrated Balancing Authority Areas ("IBAA") Tariff

Dear Mr. Mansour:

The City of Santa Clara, California, d/b/a Silicon Valley Power ("SVP") urges the Board of Governors to reject the IBAA proposal. The proposal violates existing contracts by creating charges for parallel flows, creates a "buy low, sell high" scheme that will discourage imports of energy, devalues existing transmission facilities and discourages new infrastructure, and is based on flawed modeling that will create market distortions and increased costs for CAISO Market Participants.

SVP serves approximately 500 MW of load within the CAISO BAA, utilizing a mix of resources located within its City limits, within the CAISO Balancing Authority Area ("BAA"), and outside the CAISO BAA. SVP's customers include some of California's most important high-tech companies, such as Intel and Sun Microsystems, whose costs of operation are very sensitive to fluctuations in energy rates. Through its membership in the Transmission Agency of Northern California, SVP made significant investments in the California Oregon Transmission Project ("COTP") to access resources from the Pacific Northwest to serve its native load in a cost-effective manner. SVP has previously submitted comments expressing its concerns regarding the flaws in the CAISO IBAA modeling and pricing, especially as it relates to the COTP and the overall California Oregon Intertie ("COI"). The CAISO failed to address those concerns, and instead has introduced the IBAA proposal before you now that is even worse than the approach the CAISO first proposed on December 14, 2007. The Board of Governors should seriously consider why not a single Market Participant

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supported the CAISO's most recent modeling or pricing proposal. Participants with diverse interests, representing customers within the CAISO, generators inside and outside the CAISO, neighboring Balancing Authority Areas, transmission owners, and customers outside the CAISO, opposed both the modeling and pricing approaches.

Rather than avoiding gaming risks, the flaws in the IBAA modeling and pricing will create market distortions and increased costs. The flaws will discourage imports to the CAISO of lower cost resources and renewable energy, discourage the forward supply of generation internal to the CAISO, and result in CAISO market uplifts. The following briefly summarizes the IBAA proposal's flaws.

CAISO's IBAA modeling is fundamentally flawed because it fails to use realistic estimates of COTP/COI flows. Instead, it ignores all COTP flows that sink outside of the CAISO BAA. As a result, the CAISO will consistently underestimate flows on the Pacific Intertie, and its forward market modeled flows (and prices) will not converge with real-time flows and prices. The CAISO's decision to assume zero COTP usage by COTP Participants that are outside the CAISO BAA will artificially depress forward prices for generation within the CAISO, and artificially compress the spread between Malin and the PG&E Default LAP. In real-time, the CAISO will experience greater congestion and losses from CAISO's Northwest imports than it modeled, leading to CAISO market uplift charges. Prices for generation within the CAISO will then become more valuable in real time, creating a disincentive for generation to be available in the day-ahead market. Even a simple CAISO assumption or estimation in the Day Ahead Integrated Forward Market that overall COTP usage would be proportional to PACI schedules would result in a much more realistic estimate of CAISO flows than modeling only the subset of COTP transactions scheduled with the CAISO. The CAISO will eventually have to correct this significant modeling error, but should do so as part of the initial IBAA modeling approach to avoid market disruptions with the implementation of MRTU.

In addition to the CAISO's IBAA modeling flaws, the IBAA pricing is unjust and will deprive CAISO Market Participants of valuable sources of supply. The proposed pricing fails to recognize that the COTP and the SMUD/Western/MID/TID/COTP (SWMT-BAA) facilities are highly integrated and operated in parallel with the CAISO's facilities. Because of this high degree of integration, the SWMT-BAA and CAISO transmission facilities provide reciprocal benefits; energy from CAISO resources flows over SWMT-BAA facilities and energy from SWMT-BAA resources flows over CAISO facilities (parallel flows). Despite agreements to the contrary, the IBAA pricing inequitably charges costs to COTP schedules for parallel flows, while allowing the CAISO to continue to enjoy free reciprocal use of the COTP and other SWMT-BAA facilities.

The CAISO's argument that it only imposes charges for parallel flows if the COTP energy is ultimately imported into the CAISO BAA does not avoid the contractual prohibition against charging for parallel flows, and the different treatment will cause substantial harm to the CAISO market. The CAISO relies on imports to balance its system, but the unjust charges will create a disincentive to use the COTP to import energy into the CAISO. Instead, the CAISO's IBAA proposal will encourage COTP users to sink low cost energy and renewable resources from the Pacific Northwest to neighboring BAAs. In addition, neighboring BAAs will have no incentive to supply higher cost energy from local resources to the CAISO, since the CAISO's default pricing method will incorrectly value those resources at the Captain Jack price. Furthermore, the pricing will unjustly increase the cost to use beneficial energy from the Western Area Power Administration that SVP, and other entities within CAISO, currently import (and have historically imported) to serve load.

SVP urges the Board of Governors to reject the IBAA proposal, or at a minimum, defer its decision to allow sufficient time for the CAISO, the SWMT-BAA entities and other impacted market participants to reach a mutually satisfactory mechanism for addressing their respective concerns. A decision now is premature, and will divert attention and resources towards litigation and away from the important task of developing a solution that results in accurate CAISO forward market modeling - for the benefit of all CAISO Market Participants.

Sincerely,

Ken Kolz FOR

John Roukema
Acting Director of Electric Utility

Cc: Keoni Almeida (CAISO); Tony Zimmer (NCPA); Bryan Griess (Navigant Consulting); Doug Boccignone (Flynn RCI)