

July 9, 2008

Board of Governors
California Independent System Operator
151 Blue Ravine Road
Folsom, California 95630



Re: Agenda Item 6: CAISO Proposed Decision on Uneconomic Adjustment Policy

Dear Governor:

The State Water Contractors (SWC) submits these comments regarding the CAISO's proposed modification of its Market Redesign and Technology Update (MRTU) Tariff to implement "uneconomic adjustments" to Self-Schedules, i.e., schedules for which no Economic Bid or dollar amount is specified.

The SWC is an organization representing 27 of the 29 public water entities¹ that hold contracts with the California Department of Water Resources (DWR) for the delivery of water from the State Water Project (SWP). Collectively, the members of the SWC provide all, or a part, of the water supply delivered to approximately 25 million Californians, roughly two-thirds of the State's population, and to over 750,000 acres of irrigated agriculture. The members of the SWC provide this water to retailers, who, in turn, serve it to consumers throughout the San Francisco Bay Area, the San Joaquin Valley, the Central Coast, and Southern California. All power costs incurred by the SWP are paid in full by the SWC.

The SWP water supply delivered through the Sacramento-San Joaquin River Delta constitutes a significant portion of the water supplies available to SWC members. At the Delta, water enters the SWP's Banks Pumping Plant for delivery through the California Aqueduct to SWC members in the San Joaquin Valley, the Central Coast, and Southern California. Since 1982, SWP facilities (including Banks) have received transmission service from Pacific Gas and Electric Company (PG&E) pursuant to an Existing Transmission Contract (ETC).

¹ Alameda County Zone 7 Water Agency, Alameda County Water District, Antelope Valley-East Kern Water Agency, Casitas MWD on behalf of the Ventura County Flood Control District, Castaic Lake Water Agency, Central Coast Water Authority on behalf of the Santa Barbara FC&WCD, City of Yuba City, Coachella Valley Water District, County of Kings, Crestline-Lake Arrowhead Water Agency, Desert Water Agency, Dudley Ridge Water District, Empire West-Side Irrigation District, Kern County Water Agency, Littlerock Creek Irrigation District, The Metropolitan Water District of Southern California, Mojave Water Agency, Napa County FC&WCD, Oak Flat Water District, Palmdale Water District, San Bernardino Valley MWD, San Gabriel Valley MWD, San Geronio Pass Water Agency, San Luis Obispo County FC&WCD, Santa Clara Valley Water District, Solano County Water Agency, and Tulare Lake Basin Water Storage District.

DIRECTORS

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General Manager

Terry Erlewine

The SWC wish to express their urgent concern regarding the CAISO's proposal to make "minor" Tariff revisions to relax the Tariff's current requirement to use all Economic Bids before adjusting an ETC Self-Schedule.¹ Although the CAISO's Board Memorandum states the CAISO intends to "fully honor" the rights of holders of ETCs, it cannot reconcile such a claim with its perceived need to revise the MRTU Tariff to permit unilateral modifications of valid ETC Self-Schedules. The CAISO Memorandum represents such modifications will only occur under "rare" circumstances and "in extreme system conditions that reduce grid transfer capacity in areas of the grid where these higher-priority ETC Self-Schedules would be extremely effective in providing congestion relief." It appears to the SWC that the CAISO's proposal unequivocally results in at best, a modification of the terms and conditions of SWP's ETC with PG&E or at worst, a breach of the contract, unless the CAISO can point to a provision in SWP's contract that authorizes PG&E to take such an action. SWC are unaware of such a provision. The CAISO's proposal would violate the sanctity of existing contracts. Moreover, such an adverse action may result in involuntary curtailment of SWP load at Banks Pumping Plant, which is in a load pocket.

If SWP load at Banks is curtailed, the SWP's ability to deliver precious water to millions of Californians and hundreds of thousands of agricultural farmland is jeopardized. Such curtailment could occur at a very inopportune time for the SWP. Last month Governor Schwarzenegger declared a statewide drought emergency due to historic low precipitation this water year, which was preceded by another year of low precipitation. Several years of above average precipitation will be needed to compensate for current drought conditions. Furthermore, recent judicial rulings have severely limited SWP operation of the Banks Pumping Plant to certain times when environmental conditions permit. California can ill afford to curtail SWP load when such action will cause water that would otherwise be delivered for municipal or industrial use or to irrigate farmland to be lost to the sea.

The manner in which the CAISO proposed to honor ETCs in MRTU was among the most contentious issues addressed by stakeholders in early MRTU discussions. Indeed, the CAISO's conceptual proposal for honoring ETCs was one of the first MRTU filings at the Federal Energy Regulatory Commission.² In exchange for no longer reserving transmission capacity for the exclusive use of ETC holders for schedules originating within the CAISO Control Area, the CAISO offered to fully honor valid ETC schedules by giving them a high priority, and reverse any congestion charges that might ensue. The CAISO described this as a "perfect hedge." Market participants such as the SWP relied upon that representation in giving qualified support to the CAISO's ETC proposal. The CAISO never conditioned its promise to honor ETC schedules unless they are "extremely effective in providing congestion relief." Instead, the CAISO promised to honor ETCs without qualification as to congestion; the "perfect hedge" was intended to protect ETC rights holders from the consequences of congestion. The CAISO's proposed uneconomic adjustment proposal flatly contradicts that promise.

¹ The SWC take no position on the CAISO's proposal to impose uneconomic adjustments on Self-Schedules that have lower priority than ETC Self-Schedules.

² The CAISO submitted its conceptual proposal concerning ETCs in December 2004 in FERC Docket No. ER02-1656.

To add insult to injury, SWC understand CAISO staff has indicated to SWP that once the CAISO curtails an ETC supply Self-Schedule and causes it to be unbalanced, SWP must either curtail its load to match the CAISO curtailment or pay the Locational Marginal Price (LMP) for the incremental energy procured by the CAISO to serve its load. Thus, SWP must either shed load, or pay an extremely high LMP if it wishes to continue operation as originally planned. This result demonstrates the grave harm that will be thrust upon the SWP unless the CAISO proposal is modified so that it only applies to Self-Schedules with a lower priority than ETC Self-Schedules.

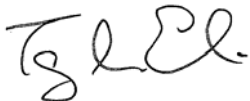
Finally, SWC object to the CAISO's proposed modification of MRTU Section 31.3.1.3, described in footnote 1 of the CAISO Memorandum. Although the CAISO admits its modification is a type of Uneconomic Adjustment, SWC note the CAISO's proposal was not fully explained by the CAISO in its original White Paper on Uneconomic Adjustment/Parameter Tuning dated May 6, or in its Revised Final Proposal dated June 9, 2008. Thus, there has been no stakeholder discussion to flesh out the ramifications of the CAISO's proposed change to Section 31.3.1.3. However, we understand that the net effect of the CAISO's proposal would be to favor Demand Self-Schedules by those entities within a Load Aggregation Point (LAP) to the detriment of entities that are unable to submit Demand Self-Schedules at the LAP. SWP is such an entity. As such, SWP fear that its Demand Self-Schedule will be more vulnerable to load shed, and disruption to SWP operations, than an entity scheduling at a LAP.

SWC understand the SWP has offered several alternative proposals to address the problems identified by the CAISO in its Memorandum. SWC urge the CAISO Governing Board to either direct the CAISO to modify its proposal to limit involuntary changes to Self-Schedules with a lower scheduling priority than ETCs, or to further consider the SWP's submitted proposals. If the CAISO limited its proposal to generic Self-Schedules, it would provide a strong incentive to the entities submitting such schedules to submit an Economic Bid so that they will have more control of their schedules. No such incentive can apply to ETC rights holders, who are required to submit a Self-Schedule.

SWC appreciate your consideration of these comments, and hope to participate in future discussions between CAISO and SWP staff to arrive at a mutually satisfactory resolution of the problems leading to the CAISO's proposal.

If you have any questions, please feel free to contact me at (916) 447-7357.

Sincerely,

A handwritten signature in black ink, appearing to read "T. Erlewine". The signature is fluid and cursive, with the first letter of the first name being a large, stylized 'T'.

Terry L. Erlewine
General Manager

Board of Governors

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Mr. Yakout Masour
President and Chief Executive Officer
P.O. Box 639014
Folsom, California 95763-9014

Ms. Linda Capuano
P.O. Box 639014
Folsom, California 95763-9014

Mr. Tim Gage
5714 Folsom Boulevard No. 127
Sacramento, California 95819

Ms. Laura Doll
P.O. Box 639014
Folsom, California 95763-9014

Mr. Tom Page
P.O. Box 639014
Folsom, California 95763-9014

Mr. Mason Willrich, Chair
38 Dudley Court
Piedmont, California 94611

Ms. Nancy Saracino
Vice President, General Counsel and Corporate Secretary
P.O. Box 639014
Folsom, California 95763-9014

Ms. Karen Edson
Vice President, External Affairs
P.O. Box 639014
Folsom, California 95763-9014