UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	Docket No. ER02-1656-000

REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION REGARDING TECHNICAL CONFERENCE

The California Independent System Operator Corporation ("ISO")[1] hereby submits its Reply Comments regarding the matters discussed at the January 28-29 and March 3-5, 2004 technical conferences held in the captioned proceeding. In its Reply Comments, the ISO responds to certain comments submitted on May 19, 2004. The ISO notes that neither its Comments filed on May 11, 2004 ("May 11 Comments"), nor the instant Reply Comments, address issues pertaining to resource adequacy. Similarly, neither set of comments addresses general issues pertaining to system and local market power mitigation; although, the comments do address mitigation issues pertaining to the ISO's residual unit commitment ("RUC") proposal. When the ISO makes its compliance filing within 60 days after the California Public Utilities Commission issues a final order in its ongoing procurement proceeding,[2] the ISO will address general resource adequacy and market power mitigation issues and submit any appropriate revisions to its MD02 proposal.[3]

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[1] Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, ISO Tariff Appendix A, as filed on August 15, 1997, and subsequently revised.

[2] The CPUC is expected to issue a final order following the conclusion of the ongoing workshops sometime this summer.

[3] In addition, the ISO will respond to the specific comments that parties submitted in the technical conference process regarding market power mitigation issues.

The ISO also stresses that, at this time, it is only seeking conceptual approval for the market design elements discussed in its May 11 Comments. That will enable the ISO to continue software development in a timely manner while simultaneously fleshing out the details of the conceptually approved design elements. The ISO acknowledges that additional details regarding certain aspects of the proposals set forth in the May 11 Comments (*e.g.,* RUC locational needs, Ancillary Services performance and locational standards for buybacks, details regarding functioning of the simplified Hour-Ahead market, more specific flexible offer obligation provisions) will have to be contained in subsequent filings, including, *inter alia*, the MD02 Tariff filing that the ISO will make. The ISO is prepared to do that and will ensure that stakeholders have a sufficient opportunity to provide input prior to the submission to the Commission.

The ISO recognizes that the Commission has not specifically stated the ISO should respond to parties' written comments and appreciates the Commission's desire to resolve promptly the technical conference issues. Given

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In addition, the May 11 Comments and the instant Reply Comments do not address issues that were not expressly set for discussion at the two MD02 technical conferences. In other words, the ISO's Comments and Reply Comments only address specific issues raised by in the January 21, 2004 "Notice of Agenda of Staff Technical Conference" and the February 27, 2004 "Notice of Agenda of Staff Technical Conference." Thus, the ISO has not addressed issues such as the appropriate methodology for allocating Congestion Revenue Rights ("CRRs"), criteria for the locational procurement of Ancillary Services (including related market power mitigation issues) and whether the use of marginal losses is appropriate. These issues – to the extent they are MD02-related -- will be addressed in greater detail when the ISO makes its MD02 Tariff filing or any subsequent conceptual filing that deals with such issue(s). Similarly, consistent with the scope of the Technical Conference scope the present filing does not address issues related specifically to Metered-Sub-Systems (MSS). In particular, this filing cannot attempt to answer the questions some of the MSS parties have raised in response to the May 11 filing. The ISO is currently developing detailed proposals regarding the treatment of MSS under MD02 and will be discussing these in the context of a stakeholder process in the near future.

the significance of the redesign effort to the electric market in California and throughout the West, the ISO hopes the Commission will benefit from the ISO's position on certain of the issues raised by Market Participants. The ISO seeks only to: (1) provide any necessary clarifications regarding the design elements proposed in the May 11 Comments, and (2) respond to arguments that were not addressed in the May 11 Comments. The ISO has attempted to respond to as many of the comments as possible given the time constraints. The ISO notes that many of the arguments raised in parties' comments were previously raised in parties' informal submission's to the ISO during the technical conference process and were addressed in the ISO's May 11 Comments. The ISO will not repeat those arguments here.[4] Similarly, the ISO believes that the issues of whether a transitional Day-Ahead ("DA") Must Offer Obligation and a permanent Real-Time Must Offer Obligation are just and reasonable have been fully briefed by all parties. These are policy issues that are ripe for a Commission decision.

I. REPLY COMMENTS

A. RUC Issues

1. An Unlimited Re-Bid Opportunity For RUC Units Is Inappropriate

Dynegy/Williams state that units whose bids are not accepted in the DA Integrated Forward Market ("IFM"), but which are selected for RUC, should be permitted to "re-price" their energy bids without limitation in the Hour-Ahead ("HA") and in Real-Time ("RT"). Dynegy/Williams Comments at 17-18.

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[4] The ISO's decision not to respond to such previously addressed arguments in the instant filing should not be considered acquiescence to parties' opposing positions or a decision to simply ignore parties' filed comment.

Dynegy/Williams state that this is necessary to mitigate the risk associated with the timing of fuel procurement.

Under the ISO's proposal, units that are selected in RUC are permitted to submit new energy bids associated with their RUC capacity provided such bids do not exceed the level of the unit's bid in the DA market. On the other hand, a unit that is not selected in the DA IFM or committed in the RUC process is not subject to such a re-bid limitation and is permitted to submit an energy bid in the HA and RT markets at any price up to the bid cap.

An unlimited re-bid opportunity for units committed in RUC is unreasonable. Given that suppliers in RUC are being guaranteed a non-rescindable Availability Payment, it is inappropriate that they should be permitted to increase their energy bids. Stated differently, if load is making a significant Availability Payment, load needs to receive some degree of certainty in connection with such payment. The situation is analogous to paying points to lock in an interest rate on a loan. No rational person would pay points and then allow the lender to set the interest rate at any rate the lender deems to be appropriate at the time of closing.[5] Further, Dynegy/Williams are seeking the same re-bid opportunity for RUC units that is being accorded to units that are not selected in the DA IFM or in RUC. However, unlike RUC units, the latter group of units are not receiving an Availability Payment. Allowing RUC units the same re-bid opportunity as units that are not receiving an Availability Payment would be unduly discriminatory.

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[5] Given that RUC capacity has a high probability of being dispatched in Real-Time, for energy, if suppliers were permitted to raise their bids once they were selected in RUC, they would have no incentive to bid competitively to increase their likelihood of being dispatched.

Once a resource is selected in RUC, guaranteed recovery of its start-up and minimum load costs, and has secured the Availability Payment, the profit maximizing strategy for the supplier in a competitive real-time energy market would be to bid variable cost for energy (out of the RUC capacity). Bidding significantly above variable cost would risk loss of market share under competitive conditions. Such a strategy could be profitable, however, if the seller is in a position to exercise market power. For example, if the seller has a dominant or pivotal portfolio and its objective is to maximize its net portfolio profit, it may very well have an incentive to bid above its marginal costs. Since, as noted above, there is a high probability that RUC capacity will be dispatched, a resource committed under the RUC process is assured of being "pivotal" in the RT market. The RUC design is not intended to substitute one type of market power (physical withholding) with another (economic withholding). Presumably, the seller would have been satisfied if the energy bid it submitted in the DA IFM (which is rolled over to DA RUC if not cleared in the IFM) was accepted in the IFM. If there was a risk that the fuel cost might increase between the close of the DA market and the Operating Hour, the risk was presumably incorporated in the DA energy bid and would not change between the DA IFM and the DA RUC process. Allowing the RUC seller to raise its RUC energy bid price after some capacity has dropped out of the competitive arena (i.e., was not selected in RUC) is tantamount to allowing the exercise of economic withholding.[6]

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[6] In its original MD02 proposal the ISO proposed to co-optimize *capacity* (e.g., Availability Payments, start-up and minimum load costs) and *energy* in the RUC process. Although the ISO has subsequently modified its proposal so that only capacity bids are to be optimized, should the ISO ever need to co-optimize capacity and energy, the ISO presumes that no party would assert

The ISO acknowledges that there is a legitimate issue regarding recovery of intra-day gas costs. However, that risk can be reflected in the Availability Payment bid and/or the energy bid. Given that the Availability Payment is not being rescinded, RUC suppliers have an opportunity to earn two payments for their service. This should be more than sufficient to "cover" any intra-day gas cost risk.[7] The ISO's proposed approach is consistent with PJM, which mitigates against suppliers ratcheting up their bids if system conditions turn out to be tighter than expected. See PJM Manual 11 (Scheduling Operations), Section 2.[8]

2. The $250 Total Payment Cap Strikes An Adequate Balance Between Providing an Incentive To Load To Forward Schedule And Encouraging Suppliers Not To "Forego" The DA Market

Duke and Dynegy/Williams suggest that the RUC total payment cap will encourage under-scheduling of load in the DA market because load serving entities will know they will not be required to pay more than $250/MW in the

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that suppliers should be able to modify their energy bids after the RUC process concludes. Under such a design, the ISO would have already made commitment decisions based on the submitted DA energy bids and thus any proposal to change those bids subsequent to the RUC process would upset the previously determined *optimal* outcome of the RUC algorithm.

[7] Dynegy/Williams suggest that an unlimited re-bid opportunity is appropriate because most RUC service will be provided via units with State resource adequacy contracts, and such contracts likely will not differentiate between DA and RUC energy strike prices, thereby failing to compensate suppliers for the risk of intra-day gas price variation. It is speculative at this time to guess what provisions may or may not be included in any State resource adequacy contract. In any event, it is not the ISO's role to dictate what compensation provisions should or should not be included in State resource adequacy contracts or to provide compensation for specific items not covered by such contracts. Presumably there will be benefits to suppliers that will make it worth their while to enter into such contracts even if they are not compensated for every conceivable risk. The relevant issue is whether the RUC re-bid mechanism has been properly designed (regardless of what the State's resource adequacy contracts look like). For the reasons discussed above, the ISO believes that its proposal is just and reasonable.

[8] Market participants in PJM can submit revised offers during the re-bid period after the DA market (from 4 to 6 p.m.) for the resources that were not committed in the DA. PJM participants thus have a chance to change their energy bids for uncommitted units after the DA market but before RUC. However, once selected in RUC (i.e., committed after 6 p.m.), they cannot change their energy bids, consistent with the present proposal. Although we do not allow a re-bid between DA IFM and RUC, there are two other significant advantages for ISO market participants that are not available in PJM. First, we allow a different bid for each hour, whereas PJM has the same bid for all hours. Second, PJM does not pay suppliers a separate non-rescindable Availability Payments in its RUC process.

Real-Time market. Duke Comments at 6; Dynegy/Williams Comments at 19. Dynegy/Williams state that a properly designed market would have separately priced Energy and capacity products without a total payment cap, but, as a compromise, they would support a total payment cap equal to 150% of the damage control bid cap. Dynegy/Williams at 19.

Obviously higher Availability Payment and RT Energy bid caps and less mitigation will motivate greater forward scheduling by Load Serving Entities ("LSEs"). However, that is only half of the equation. The other half of the equation is to eliminate the incentive for suppliers to "avoid" the DA market by submitting excessively high bids that will not clear so they can be eligible to receive both a RUC Availability Payment and an Energy payment. The ISO's proposal adequately balances these two objectives. First, the ISO's RUC proposal provides maximum cost exposure to LSEs that is similar to the maximum cost exposure they would have faced if they had bid into the DA market. Stated differently, LSEs bidding into the DA market would not face cost exposure greater than $250; that is the maximum cost exposure in RUC. Second, even though LSEs' total cost exposure is capped, LSE's are still subject to two charges in the RUC process— responsibility for an Availability Payment and an Energy payment. Thus, LSEs face a much greater risk that the amount they end up paying in RUC will be greater than the cost risk they face in the DA market where they face only an Energy payment.

In its May 11 Comments, the ISO addressed the argument that the total payment cap blurs the distinction between Energy and capacity -- Given that

RUC selection occurs immediately after the close of the DA market, suppliers do not have any legitimate expectation to be earning more than $250. RUC provides an opportunity for suppliers to receive two payments (Availability Payment and Energy) and earn more revenue (up to a $250 cap) than they would otherwise with just a DA Energy bid.

If the Commission believes that a total payment cap is an inappropriate concept, then the Commission should set the Availability Payment bid cap no higher than $100 (along with a $250/MWh energy bid cap). A $100 Availability Payment cap would at least recognize the distinction between RUC capacity, which is procured with the expectation that it will be dispatched, versus A/S capacity which is not procured to meet an expected energy need. A $100 Availability Payment cap is also consistent with the ISO's Replacement Reserve cap that was previously in effect, with the important difference that the capacity payment for Replacement Reserve was rescinded when the resource was dispatched for energy. In the Replacement Reserve market, the most a supplier could receive was the $100 capacity cap if it was not dispatched, or the $250 energy cap if it was dispatched, but not the sum of the two. A If the RUC Availability Payment is not to be rescinded, then a $250 total payment cap would provide a more appropriate balance of incentives for suppliers and LSEs as described above.

B. Ancillary Services Procurement

Powerex objects to what it reads as the ISO's complete prohibition of supplier buy-back in the Hour Ahead market of A/S sold in the Day Ahead

market. Powerex at 5. This interpretation is inaccurate and the objections somewhat surprising. The discussion by Powerex and other participants at the March 3-5 Technical Conference led to the conclusion that the primary concern of A/S suppliers (with the exception of Metered Sub-Systems or MSS, whose concern is addressed below) is the ability to substitute a different resource in the HA market to provide A/S capacity that was sold in DA. Consistent with that discussion, the ISO *agreed* in the May 11 Comments to allow such substitution, provided the substitute resource met applicable performance and geographic location criteria. The ISO reaffirms that this capability will be preserved in the Simplified Hour Ahead Market proposed in the May 11 Comments.

Powerex's comments go further than the position Powerex stated at the Technical Conference, however, and argue for a complete Hour Ahead A/S market in which the ISO is able to defer A/S procurement in DA and procure the gap in HA, and suppliers are able to participate as buyers and sellers. The ISO thought that the Technical Conference discussion made it clear that economic deferment by the ISO is not a feasible option due to the ISO's need to meet its A/S requirements fully in the DA. Given this requirement it is not acceptable to expect the ISO to manage the uncertainty that would exist if suppliers were able to withdraw DA-committed A/S resources in HA without providing acceptable substitute resources. The same argument applies to the suggestion that the ISO should defer some DA A/S procurement in anticipation of additional A/S self-provision in HA, without a firm commitment by such self-providing parties to a specific quantity of suitable A/S resources to be identified in HA. This argument

also applies to the desire expressed by MSS parties at the Technical Conference to be able to withdraw DA-committed A/S capacity so that they can effectively follow their own load in Real Time. The common theme in the ISO's response to all of these points is that the ISO needs to minimize, by the end of the DA market process, uncertainty regarding the resources that are committed to provide A/S for the following day. Any such uncertainty must be limited to changing conditions such as outages and load forecast revisions, and acceptable substitution by suppliers as described in the May 11 Comments.

NCPA argues for a more extensive HA buy-back capability with respect to use-limited resources that may provide A/S for 24 hours of the day but could not be fully dispatched for all those hours due to their use limitations. NCPA at 8-9. The ISO points out that NCPA's argument seems to ignore the "contingency-only" provision, which exists today and will be preserved under MD02, whereby a supplier of Operating Reserves can flag the resources "contingency-only" to limit the dispatch of those resources to actual contingency conditions, rather than allowing them to fully participate in the Real-Time Economic Dispatch. Moreover, any use limitations indicated in the DA bid submission by the SC for a resource will be taken into account in the DA IFM when it performs its optimization for the 24 hours of the following day.

C. Marginal Losses

1. Allocation of Over-Collected Marginal Losses To Exports

Powerex states that exports should be allocated a portion of over-collected losses because exports pay for marginal losses. Powerex Comments

at 3. Powerex and SMUD also claim that if the CRR Balancing Account is approved as the mechanism for refunding loss over-collection, then CRRs should be allocated to any entity that contributes materially to the embedded cost of the transmission system, not solely to those entities that serve load within the ISO Control Area. Powerex Comments at 3-4; SMUD Comments at 8-11.

Exports and parties who serve load outside the ISO Control Area benefit from the ISO's marginal loss over-collection proposal in a number of ways. First, the CRR balancing account benefits all holders of CRRs without distinguishing between those who received an allocation of CRRs and those who purchased CRRs at auction. Thus, to the extent exporters and other entities obtain CRRs, whether via an allocation or through the auction process, the loss over-collection funds will help ensure that they receive the full value of their CRRs. Second, any surplus funds in the CRR Balancing Account at the end of each year are ultimately flowed through to loads and exports by being paid to Participating Transmission Owners to reduce the transmission and wheeling Access Charges.

The ISO notes that CRR allocation issues are being addressed in a different stakeholder process that ultimately will lead to a filing(s) with the Commission seeking approval of the MD02 CRR allocation rules. Moreover, the Commission did not set CRR allocation issues for consideration in this technical conference process. The issue raised by Powerex and SMUD will be addressed in the CRR stakeholder process which is still in the early phases. In any event, the ISO recognizes that Commission precedent holds that parties taking long-term (*i.e.* for one year or more) firm transmission service should receive CRRs.

The rationale for this precedent is that parties that are making a **significant** contribution to embedded costs should receive CRRs. As the ISO has recognized in two previous MD02 filings with the Commission, it may be appropriate for parties that pay the wheeling charge on a long-term, daily basis to be allocated CRRs. However, at this time, the ISO does not believe that "part time" or sporadic users of the grid should be entitled to the same CRR rights as parties that use the grid on a "24-7" basis. The ISO is committed to further discussion of this issue in the CRR stakeholder process.

MWD argues against allocating loss over-collections to the CRR Balancing Account based on a mistaken assertion that the CRR Balancing Account is not needed to ensure CRR revenue adequacy because the ISO collects congestion charges from multiple markets (DA and RT) but pays CRR holders only for their DA schedules. MWD at 7. It is important to clarify that the ISO pays CRR holders for the full amount of their CRR holdings, not on the basis of their schedules. The only relevance of the DA market to this payment is the fact that DA prices are used for calculating it. MWD seems to believe that the ISO will collect congestion revenues more than once for the same MWh flows. The fact is that the total amount of CRRs that can be released through the allocation/auction process can be no greater than the total MWh volume of energy flows through the grid in a given hour, for a given set of system conditions. Congestion charges collected in the ISO markets (DA and RT) are for different shares of those total MWh, not for the same MWh twice. CRR revenue shortfalls can thus occur any time transmission facilities are derated or

out of service, and therefore the CRR Balancing Account is necessary, and all CRR holders benefit by the use of this account as a means of refunding over-collected loss revenues.

D. Simplified Hour Ahead Market

1. An Opportunity For Hour Ahead Load Bid Adjustments And Self-Schedules Is Not Necessary

SCE recommends that the Simplified HA market be revised to include the opportunity for load to bid adjustments and to submit self-schedules. SCE Comments at 14. SCE states that this is necessary given the Commission's May 6, 2004 Order on Rehearing in the ISO's Amendment No. 55 proceeding, wherein the Commission made implementation of an over-scheduling load penalty contingent on a symmetrical penalty for under-scheduled load.

In its Amendment No. 55 compliance filing that was filed on May 20, 2004, the ISO eliminated its proposal to implement an over-scheduled load penalty and did not propose a penalty for under-scheduled load. Accordingly, SCE's concerns have been addressed, and there is no need for an opportunity for load to bid adjustments and to submit self-schedules.

SWP expresses a similar concern, arguing that it "might need to adjust its load schedule downward, perhaps reducing load by hundreds of MW." SWP at 5. SWP then expresses concern that such a load reduction could become a liability under Obligation CRRs by exposing it to charges for congestion in the opposite direction of its CRRs. This concern is unfounded because the only settlement for CRRs is based on the DA market. Once CRR settlement is

determined based on DA prices, it cannot be altered by any change in congestion patterns that may occur in either the HA or RT markets. The only impact of the Simplified HA market on post-DA load reductions is that such reductions would sell their DA-scheduled excess Energy at the RT price rather than at a distinct HA price.

2. Clarification Of Some Details Of ISO Proposal

IEP raises a number of questions concerning the proposed HA market design, in response to which the ISO offers the following clarifications.

First, the ISO does not propose to eliminate the possibility of procuring additional A/S in the HA market, nor do we propose to eliminate the HA RUC procedure. As indicated in the discussion above of A/S procurement, the ISO will not intentionally defer A/S procurement to the HA market for economic reasons. There will be instances, however, when changing conditions after the DA market – such as load forecast revisions and plant outages – will require additional A/S procurement in HA. The Simplified HA market will optimally procure the needed additional reserves in the context of an HA imbalance Energy pre-dispatch, in a manner analogous to Real-Time A/S procurement. Second, with regard to the HA RUC, the ISO proposes to retain the ability, as proposed in the July 2003 filing, to use the HA time frame to commit resources that require less than five hours start-up time. Thus the Simplified HA market proposal does not imply or require any changes to the design of the DA A/S market nor to the DA or HA RUC processes.

PowerEx asks the ISO to clarify the proposed HA time line. The ISO intends to close the HA market and the RT market to bid submissions somewhere between T-75 and T-60. Recognizing the importance of closing the markets as close as possible to the start of the operating hour, the ISO will set the closing time as close to T-60 as possible given the required sequence of software runs that must occur between market close and the publication of HA and RT pre-dispatch instructions by T-45. In contrast, today's HA market closes at T-135 while the RT market closes at T-60. The significant implication of this fact is that today, SCs have no opportunity after T-135 to submit proposed schedule changes for internal generation or for use of the inter-ties and to have such schedule changes confirmed and accepted by the ISO. The Simplified HA market proposed under MD02 will provide such capability up to at least T-75 and hopefully up to T-60.

SWP asks for further clarification of the ISO's proposal to issue "advisory" Real Time A/S awards in the context of the Simplified HA market. SWP at 5. The ISO's proposed Simplified HA market is an extension of the Real-Time pre-dispatch that was an element of the original MD02 proposal as far back as the May 1, 2002 filing. In the context of RT optimization, both in the pre-dispatch time frame and within the Operating Hour, A/S designation is based on the optimal use of resources to provide either Energy or capacity. In the HA market this will only be advisory because the designation of resources for A/S will be re-optimized within the Operating Hour as appropriate to meet changing needs. Resources that have Energy bids and are dispatchable in RT may thus be used

either for A/S or Energy as determined by the RT Economic Dispatch. Thus, in the Simplified HA market, the A/S results are provided to SCs, along with their pre-dispatch instructions, on an advisory basis with the understanding that resources capable of being dispatched within the Operating Hour may receive further intra-hour dispatch instructions or A/S awards. For such resources their RT and HA settlement will ultimately depend on any RT modifications to the HA results.

3. Asserted Negative Impacts Of Simplifying The HA market Are Exaggerated

Sempra argues that it is necessary to have an HA market that offers a distinct settlement from the RT market. The ISO emphasizes that having a two-settlement system (DA and RT) instead of a three-settlement system is a major source of the design simplification and reduction in cost – both for MD02 implementation and ongoing, for participants as well as for the ISO – that result from adopting the proposed Simplified HA market.

Moreover, the ISO would argue that Sempra exaggerates the negative impacts of not having an HA settlement. One such issue is the uplift that would be required for supply bids accepted in the HA pre-dispatch whose bid prices are above the applicable RT LMPs. Based on the discussion at the March 3-5 Technical Conference, the ISO understands that a primary need for the HA market is on the part of parties wishing simply to be able to self-schedule supply to meet their own load when they revise their load forecasts or procure supply after DA through bilateral transactions. Such self-scheduled supply resources would be price takers in RT and would not contribute to any uplift charges.

Another such issue raised by Sempra concerns the ability to utilize Inter-SC Trades. The ISO points out that the Simplified HA market proposal does not in any way alter the Inter-SC Trade mechanism proposed under MD02. Parties who wish to utilize the Inter-SC Trade mechanism would still be able to submit such trades in the HA time frame. Moreover, with the Simplified HA market the closing time for such submissions would be much closer to RT than it is today or than it would be under the July 2003 MD02 proposal. Because such trades represent zero net injection or withdrawal at their location and are offered purely as an accounting and settlement convenience for SCs, they do not affect the IFM optimization or the resulting prices. Therefore the Simplified HA market does not need to take such trades into account. Sempra is correct in noting that Inter-SC Trades under MD02 are purely financial and do not have the physical delivery aspect they have today, but this is a result of eliminating today's balanced schedule requirement, and is not a property of the Simplified HA market design.

Sempra also asserts that the Simplified HA market would preclude the ISO from procuring additional A/S if necessary and would prohibit suppliers of DA A/S from substituting more efficient resources to fulfill their DA A/S commitments. Both of these assertions are incorrect, as discussed in the ISO's May 11 filing.

4. Hedging Hour Ahead Congestion Cost Exposure

MWD argues that the proposed Simplified HA market would not allow parties to submit bids to limit their exposure to congestion costs or to otherwise hedge such exposure. MWD frames this concern in the context of a LSE wishing to submit an HA modification to its DA schedule, presumably by self-scheduling

additional supply resources to serve its anticipated additional load. In response, the ISO points out that this is not the result of the Simplified HA market; rather, the same concern would exist under the July 2003 HA market proposal. To illustrate this fact, consider the LSE who wishes to self-schedule in the HA market 100 MWh of supply at node A to serve 100 MWh of anticipated load. By submitting such a self-schedule the LSE would be exposed to a charge of 100 MWh times [load aggregation price minus nodal price at A] to cover congestion and losses. Under the July 2003 proposal this charge would be calculated using HA prices, whereas under the Simplified HA market proposal it would be calculated using RT prices, and the load quantity would be based on RT metered load instead of HA scheduled load. In either case, the LSE is exposed to charges over which it has no control due to the fact that it chose to self-schedule the supply resource rather than submit Energy bids. Since the load will be settled at the load aggregation price, which averages nodal prices across all buyers in the aggregation zone, the volatility of load prices will be far less than the volatility of individual nodal prices paid to generators, so the main cause for concern by the LSE should be the possibility that its self-scheduled generation would be settled at a low nodal price. The LSE can best manage this risk – under either the July 2003 HA market design or the Simplified HA market – by submitting an Energy bid on its supply resource rather than being a price taker. By submitting a high enough bid the LSE can ensure that its resource will not be scheduled if the price at node A is too low. In such cases – again, under either

design – the 100 MWh of LSE load will be served in the least cost way from the market.

Alternatively, if the resource at A does clear in the HA pre-dispatch market, it will be guaranteed to receive at least its bid price, and may receive more if the RT price at node A is higher. In conclusion, MWD's concern is not an issue with the Simplified HA market proposal. Moreover, MWD and other LSEs that wish to use their own resources to serve their load can manage their exposure to post-DA congestion charges by bidding such resources into the market rather than relying exclusively on the self-scheduling mechanism.

II. CONCLUSION

Wherefore for the foregoing reasons, the ISO requests that the Commission act on the ISO's Revised Comprehensive Market Design Proposal in a manner consistent with the discussion herein.

June 2, 2004

Respectfully submitted,

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CALIFORNIA ISO

June 2, 2004

The Honorable Magalie Roman Salas
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: Docket No. ER02-1656-000
California Independent System Operator Corporation

Dear Secretary Salas:

Enclosed for electronic filing please find the Reply Comments of The California Independent System Operator Corporation Regarding Technical Conference in the above captioned docket.

Thank you for your assistance in this matter.

Respectfully submitted,

Sidney L. Mannheim
Counsel for The California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned docket.

Dated at Folsom, California, on this 2nd day of June, 2004.

Sidney L. Mannheim