

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System) Docket No. ER02-1656-026
Operator Corporation)

**REPLY COMMENTS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to the Federal Energy Regulatory Commission's ("Commission") September 23, 2005 "Notice of Deadline for Comments and Reply Comments," the California Independent System Operator Corporation ("CAISO") hereby submits its Reply Comments on the technical conference held in San Francisco on September 13, 2005 in the captioned proceeding ("Demand Response Technical Conference").

In support hereof, the CAISO respectfully states as follows:

I. BACKGROUND

The following issues were discussed at the Demand Response Technical Conference: (1) Special Case Nodal Pricing ("SCNP"); (2) allowing individual wholesale customers to establish their own load aggregation zones and opt out of the CAISO's proposed load aggregation scheme; and (3) demand response in California and under the CAISO Tariff. On September 27, 2005, the CAISO and other parties filed initial comments addressing the issues discussed at the Demand Response Technical Conference.

The instant Reply Comments address issues raised in parties' initial comments that were not already addressed in the CAISO's Initial Comments. In particular, the

Reply Comments respond to arguments raised in the initial comments filed by the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (the “Southern Cities”), Metropolitan Water District of Southern California (“MWD”), and the California Department of Water Resources State Water Project (“SWP”).

Certain parties have taken positions in their initial comments regarding the merits of issues that the CAISO believes are beyond the scope of the issues set for consideration in the Demand Response Technical Conference. The CAISO will not address such arguments in these Reply Comments because they are appropriately dealt with elsewhere. For example, SWP (1) objects to the number of Load Aggregation Point (“LAP”) zones proposed by the CAISO, (2) urges the Commission to direct the CAISO to establish more LAP zones, and (3) in the absence of such development, requests that the Commission order the CAISO to implement the sub-zones already studied by the CAISO in the Market Redesign & Technology Upgrade (“MRTU”) stakeholder process.¹ SWP Initial Comments at 3-6, 17-22. The issue of the appropriate number of load zones was not set for consideration at the Demand Response Technical Conference. In that regard, the “Supplemental Notice of Technical Conference” issued on September 8, 2005 specified only the following issue for consideration at the Technical Conference:

- III. Establishment of LAP Zones for Wholesale Customers: Discussion of issues and potential impacts of allowing individual wholesale customers to establish their own LAP zones.

¹ The CAISO has not reached any conclusions regarding what the appropriate sub-zones are. The CAISO has used sub-zones in both the LMP and CRR studies. However, the CAISO has made it clear that the sub-zones used in the LMP studies are preliminary in nature and are being used only for illustrative purposes. Further, the sub-zones used in the CRR studies are somewhat different than the sub-zones used in the LMP studies. Thus, there currently is no single set of sub-zones that would be meaningful to implement.

Thus, the appropriate issue for resolution via the technical conference process is whether wholesale customers should be permitted to opt out of the CAISO's load aggregation, not how many LAPs the CAISO should be required to establish. The position taken by SWP (at pages 17-22 of SWP's initial comments) pertains to the latter issue and is appropriately addressed in the MRTU stakeholder process and the CAISO's November 30, 2005 MRTU tariff filing, not in comments on the Demand Response Technical Conference. To that end, the CAISO has issued a white paper regarding the issue of the appropriate number of LAP zones,² and this issue will be vetted with stakeholders at the October 5-6, 2005 stakeholder meeting. The CAISO intends to address that issue comprehensively in its November 30, 2005 MRTU tariff filing. This approach for dealing with the appropriate number of LAP zones is consistent with the process envisioned by the Commission in its September 19, 2005 order on rehearing in the captioned docket. In that order, the Commission

[d]irected [the CAISO] to re-examine its proposed LAP zones and, after taking into account the results of CRR [Congestion Revenue Rights] Study 2 and its stakeholder process, disaggregate the zones further. We rely on the CAISO and market participants to complete this process expeditiously so that the CAISO can include a full proposal in its November 30 tariff filing.

California Independent System Operator Corporation, 112 FERC ¶ 61,310, at P 20 (2005). Accordingly, the instant Reply Comments appropriately focus only on the narrow issue of whether individual wholesale customers should be permitted to opt out of load aggregation.

² On September 15, 2005, the CAISO posted on its website a white paper entitled *Granularity of LAPs for Spot Market Scheduling and Settlement*.

The Southern Cities' initial comments focus on the issue of whether a large number of LAP zones will interfere with the ability of load serving entities with internal generation to obtain effective hedges against congestion costs. As recognized by the Southern Cities, this issue is addressed in the CAISO's CRR Study 2,³ which will be discussed with stakeholders at the upcoming stakeholder meeting. This issue – which is intricately related to the issue discussed in the preceding paragraph – will be addressed in the CAISO's November 30, 2005 Tariff filing. The Southern Cities' issues regarding the results of CRR Study 2, the efficacy of CRRs, and the interrelationship between CRRs and the number and size of LAP zones are best addressed in connection with the November 30 MRTU Tariff filing and not in comments on the Demand Response Technical Conference.

II. REPLY COMMENTS

A. It Is Appropriate Not To Allow Any Opt-Out Of The CAISO's Load Aggregation Scheme For A Transition Period.

SWP and MWD object to the CAISO's proposal not to allow any opt-out of the CAISO's load aggregation scheme. They argue that individual wholesale customers should be permitted to opt out of load aggregation. They also argue that the CAISO's "no-opt-out" proposal improperly results in wholesale customers subsidizing retail customers.

In its Initial Comments, the CAISO stated why it is appropriate not to allow any opt-out of load aggregation upon the start-up of the LMP market regime. There is no need to repeat those arguments here. SWP and MWD appear to assume that load

³ The CAISO notes that it filed its CRR Study 2 in the above-captioned docket on September 30, 2005.

aggregation will remain in place *ad infinitum* and, as such, it needs to be stopped now. That is likely an incorrect premise given the Commission's preference for more granular pricing and the fact that the CAISO is building into its MRTU software the flexibility needed to accommodate nodal pricing for loads.

A load aggregation scheme with no opt-out is clearly appropriate as a transition mechanism for the reasons discussed in the CAISO's Initial Comments. Further, the Commission has long recognized the appropriateness of phase-in and transition measures to mitigate the impact of rate design proposals that might otherwise have a significant cost impact or result in cost shifting.⁴ This is one such instance where a transition mechanism is appropriate. For example, the Commission approved load aggregation for ISO New England as a transitional mechanism. *New England Power Pool and ISO New England*, 100 FERC ¶ 61,287 (2002). The CAISO is essentially seeking the same treatment that the Commission accorded ISO New England and, in its Initial Comments, the CAISO identified a plan and timeline that would allow the Commission and stakeholders to evaluate SCNP and opt-out provisions after the CAISO obtains one year's experience with LMP.⁵ MWD and SWP do not offer any

⁴ See *New England Power Pool and Massachusetts Municipal Wholesale Electric Company*, 83 FERC ¶ 61,045, at 61,237-41 (1998); *California Independent System Operator Corporation*, 91 FERC ¶ 61,205, at 61,725 (2000); *Midwest Independent Transmission System Operator, Inc.*, 109 FERC ¶ 61,157, at P 80 (2004).

⁵ The Southern Cities, SWP, and MWD all claim that the cost impact of permitting individual wholesale customers to opt out will not be that great, and they argue that that the CAISO has failed to quantify the cost impact on "trapped customers" if individual wholesale customers are permitted to opt out. However, SWP, MWD, and the Southern Cities have themselves not quantified the alleged minimal cost impact that an opt-out for wholesale customers will have. The incontrovertible fact is that, at this point, no one knows what the exact impact of LMP will be in California and what the exact impact of allowing an opt-out will be. That is why a prudent course of action demands that the CAISO first gain experience with LMP before it makes recommendations (and the Commission approves mechanisms) regarding implementation of SCNP and wholesale customer opt-out. That way, the CAISO and stakeholders can comprehensively and rationally evaluate the cost impact of LMP, as well as the potential impacts, costs, and benefits of SCNP and wholesale customer opt-outs, based on a more complete "record."

convincing reasons why a no-opt-out policy is inappropriate or imprudent as a transition mechanism.

B. SWP's Concerns Are Adequately Addressed By The CAISO's MRTU Release 1 Proposals.

SWP appears to be confused as to whether the CAISO's proposals to be implemented in MRTU Release 1 will allow for SWP's Participating Load to be priced nodally for both energy use and demand response. As the CAISO indicated in its Initial Comments, SWP's load that is served under existing transmission contracts will be priced nodally. Further, under the Participating Load Program – in which SWP is a participant – SWP's Participating Load scheduled in the Day-Ahead will be priced based on the applicable Day-Ahead nodal price, and any additional consumption in Real-Time, as well as any demand response in Real-Time pursuant to a CAISO dispatch instruction, will be priced based on the applicable Real-Time nodal price. SWP's Participating Load will be scheduled and settled at the individual nodal level rather than at the LAP level. Thus, SWP's concerns that its energy usage (as opposed to its demand response) might not be priced nodally are unfounded.

At page 17 of its initial comments, SWP seems to imply that SWP's eligibility to receive nodal pricing as a Participating Load will be subject to CAISO modeling practices and that such modeling practices can be subject to *ad hoc* and unilateral CAISO action. SWP states that objective criteria regarding the eligibility for the Participating Load Program and the pricing of Participating Load need to be set forth in the Tariff. The concerns expressed by SWP are wholly unfounded. The eligibility criteria for and treatment of Participating Loads will be set forth in the MRTU Tariff. The CAISO notes that it does not intend to change the eligibility criteria for Participating

Loads under MRTU from that in effect today. The CAISO will not subjectively be determining on an *ad hoc* basis who qualifies for treatment as a Participating Load and how Participating Load will be priced.

III. CONCLUSION

For the reasons set forth herein, and in the CAISO's Initial Comments, the Commission (1) should not require SCNP for Release 1 of MRTU, and (2) should not permit individual wholesale loads to opt out of the CAISO's proposed load aggregation scheme.

Respectfully submitted,

/s/ Anthony J. Ivancovich

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Date: October 4, 2005



October 4, 2005

Via Electronic Filing

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

**Re: California Independent System Operator Corporation
Docket Nos. ER02-1656-026**

Dear Secretary Salas:

Enclosed please find an electronic filing of Reply Comments of The California Independent System Operator Corporation.

Thank you for your attention to this filing.

Respectfully submitted,

/s/ Anthony J. Ivancovich
Anthony J. Ivancovich

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 for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California, on this 4th day of October, 2005.

/s/ Anthony J. Ivancovich
Anthony J. Ivancovich