UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

REQUEST FOR CLARIFICATION AND REHEARING OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION AND REQUEST FOR EXPEDITED COMMISSION ACTION

Pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 251 (a) (2001), and Rules 212 and 713 of the Commission's Rules of Practice and Procedure 18 C.F.R. §§ 385.212 and 385.713, the California Independent System Operator Corporation ("CAISO")[1] hereby submits this Request for Clarification and Rehearing of the Commission's order issued on July 1, 2005, 112 FERC ¶ 61,013 (2005) ("July 1 Order") acting on the CAISO's May 13, 2005, filing of amendments to certain elements of the conceptual Market Redesign and Technology Upgrade ("MRTU") proposal. For the reasons explained below, the CAISO requests that the Commission act on this Request by no later than the end of September.

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

I. REQUESTS FOR CLARIFICATION AND SPECIFICATION OF ERRORS

The CAISO respectfully submits that the July 1 Order erred in the following respects:

- The Commission erred by requiring the CAISO to increase the number of load aggregation point ("LAP") zones and in permitting individual wholesale customers to "opt out" of load aggregation by establishing their own separate LAP zones.
- The Commission erred in rejecting the CAISO's proposal to apply local market power mitigation measures to Residual Unit Commitment ("RUC") Availability Bids because such mitigation measures are necessary to ensure that RUC market clearing prices are just and reasonable.
- The Commission should clarify that the Commission did not intend to preclude the CAISO from including in its November 2005 filing of MRTU tariff provisions protections to ensure that resources being compensated for satisfying Resource Adequacy ("RA") requirements will not be eligible to receive RUC Availability Payments. To the extent that the July 1 Order could be read to preclude the inclusion of such protections in the CAISO Tariff, the Commission erred because: (1) procedurally, it would be premature for the Commission to rule on this issue prior to completion of the stakeholder process and presentation of a full record to the Commission; and (2) failure to prevent RUC Availability payments to RA units under the CAISO Tariff would introduce tremendous complexity in the Resource Adequacy program being developed by the California Public Utilities Commission ("CPUC"). This complexity includes the difficulty in determining how to credit back RUC Availability Payments to Load Serving Entities ("LSEs") paying for RA

capacity, particularly since capacity from a single RA unit can serve the RA requirements of multiple LSEs.

The CAISO also requests that the Commission provide the following clarifications with respect to the July 1 Order:

- The Commission should clarify that the solution to the problem of settling intertie bids proposed in the CAISO's recent filing in the Amendment No. 66 docket may be temporary, and that a more permanent solution to this issue will be developed through the MRTU stakeholder process and implemented as part of HASP in February 2007.
- The Commission should clarify that the ISO is not required to calculate the incremental costs of using bid adders in calculating LMPs and then to allocate these costs to LSEs based on their share of under-procured capacity.
- The Commission should clarify that the CAISO is not required to include RUC self-provision in its November 2005 MRTU Tariff Filing if the CAISO concludes, based on input received through the stakeholder process, that this feature should not be included in the MRTU Release 1 market design.

II. BACKGROUND

On May 13, 2005, the CAISO filed with the Commission a further amendment to its Comprehensive Market Design Proposal ("May 13 Filing").[2] Therein, the CAISO requested that the Commission grant conceptual approval to allow the CAISO to

[2] In this Request, citations to the transmittal letter for the May 13 Filing will be to pages of the "Transmittal Letter," and citations to the other lettered attachments to the May 13 Filing will be to those particular attachments.

implement as part of MRTU the following design elements: (1) the clearing of demand bids at the LAP level; (2) a revised HASP; and (3) a package of market power mitigation measures to be in place upon implementation of MRTU in February 2007.

A number of parties filed comments and protests concerning the May 13 Filing. On July 1, 2005, the Commission issued an order addressing the May 13 Filing. Therein, the Commission granted conceptual approval to the majority of the market design elements proposed in the May 13 Filing, required modifications of some aspects of the May 13 Filing, and solicited additional information and explanation of other portions of the CAISO's proposal.

The CAISO greatly appreciates the Commission's expedited action on the May 13 Filing and requests rehearing or clarification of only a handful of items in that comprehensive order.

III. REQUEST FOR EXPEDITED COMMISSION ACTION

As discussed in prior MRTU filings, the CAISO is working with stakeholders to finalize elements of MRTU Release 1 and to prepare implementing tariff provisions (the "MRTU Tariff") that will be filed for Commission approval by November 30, 2005. Certain of the CAISO's requests for rehearing or clarification, such as the request for rehearing of the Commission's determination to permit load zones for individual wholesale customers, will have significant implications for the MRTU Tariff language.

In addition certain of the clarifications requested by the CAISO are needed to determine how the provisions of the CAISO's MRTU Tariff filing will interact with the Resource Adequacy Requirements being developed by the CPUC. In particular, the

CAISO has requested clarification that it can include in the MRTU Tariff, protections designed to prevent units being compensated for satisfying Resource Adequacy Requirements from receiving double payment in the form of RUC Availability Payments. If these protections are not included in the MRTU Tariff, as currently contemplated, then the CPUC likely will need to make revisions to its Resource Adequacy program that will require RA units to credit back such RUC Availability Payments to LSEs. The CAISO anticipates that the CPUC will finalize the details of the Resource Adequacy Requirements in an order to be issued by October of this year. It is important that the Commission clarify its position on this issue before the CPUC issues its RA order.

The CAISO intends to seek final Board approval for all of the MRTU design elements to be included in the November MRTU Tariff filing at the October CAISO Board meeting and, during the week of October 24-28, the CAISO will undertake a MRTU Tariff page turn with stakeholders. Under these circumstances, Commission action on these rehearing and clarification requests is needed prior to October, in order to prevent delay in California's market design efforts and to avoid the need to revisit the MRTU Tariff language or revise the CPUC's Resource Adequacy Requirements. Accordingly, the CAISO therefore requests that the Commission act on this Request by no later than September 30, 2005.

IV. REQUEST FOR REHEARING AND CLARIFICATION

A. The Commission Should Reverse its Decisions to Require the CAISO to Increase the Number of LAP Zones and to Permit Individual Wholesale Customers the Option of Establishing Separate Zones for Purposes of Aggregating Load

In its July 22, 2003 MRTU Filing ("July 22 Filing"), the CAISO proposed that loads within the CAISO Control Area that are not served under ETCs would schedule, bid and settle at one of three LAPs corresponding to the service territories of the three investor owned utilities ("IOUs") in California. For purposes of running the Integrated Forward Market ("IFM"), the CAISO proposed to distribute submitted load bids and self-schedules to individual nodes using Load Distribution Factors ("LDFs"). Once the IFM determines the final schedule, the CAISO would then re-aggregate nodal load schedules to the LAP level for the purpose of providing these schedules to Scheduling Coordinators and for settlement. The CAISO proposed to make its load aggregation mandatory so that loads would not have the option to "opt-out" of the aggregation. In its October 28, 2003 order addressing the July 22 Filing,[3] the Commission accepted the CAISO's proposal to aggregate prices for load over the three existing IOU service territories. October 28 Order at P 65.

In the May 13 MRTU Filing, although retaining the basic concept of aggregating load prices over the three existing IOU service territories, the CAISO, in response to concerns raised by its consultants LECG, proposed a revised methodology for clearing load bids. Specifically, the CAISO proposed to clear LAP-level load bids based on LAP prices. Thus, the LAP-level demand curve would not be distributed to nodes for clearing in the IFM, but instead, would be cleared against the aggregated LAP prices to

[3] 105 FERC ¶ 61,140 (2003) ("October 28 Order").

produce a final LAP-level load schedule that is consistent with the accurate LDFs used initially to allocate load to nodes. Transmittal Letter at 19-20.

In the July 1 Order, the Commission approved the CAISO's proposal to modify its methodology for clearing load bids in order to clear those bids at the LAP level. July 1 Order at P 34. However, in response to comments arguing for the disaggregation of LAP zones beyond the three zones corresponding to the IOUs, the Commission directed the CAISO to increase the number of currently proposed load aggregation zones. Although the Commission recognized that the appropriate number of zones to disaggregate to was an issue for further discussion between the CAISO and Market Participants, the Commission indicated that, at a minimum, "each wholesale customer should have the option of establishing, as a separate zone, the set of nodes where it receives energy." July 1 Order at P 37. By doing so, the Commission has effectively granted customers the ability to "opt out" of the CAISO's load aggregation scheme. For the reasons set forth below, the CAISO requests rehearing of these rulings.

1. The Commission's Rulings Are Procedurally Defective

The Commission's decision that the CAISO must disaggregate its LAP zones, as well as its ruling that customers will be permitted the option of establishing their own separate LAP zones, goes beyond the LAP issue presented by the CAISO for approval in the May 13 Filing, which was whether it was just and reasonable for the CAISO to modify its methodology for clearing load bids in order to clear those bids at the LAP level, rather than distributing load bids to individual nodes using LDFs. Because the CAISO's proposal in the May 13 Filing did not concern either the granularity of LAP zones or whether customers should be permitted to establish their own LAP zones,

parties had no notice that it was appropriate or necessary to comment on these topics in pleadings submitted to the Commission concerning the May 13 Filing. Not surprisingly, many parties did not, in fact, address these issues in their comments on the May 13 Filing. By deciding this issue without giving parties, including the CAISO, a full and fair opportunity to present their views on this issue the Commission has deprived these parties of due process. Moreover, because parties did not have an opportunity to comment on these issues, the Commission's decisions are the product of an incomplete record, and thus, cannot be said to be supported by substantial evidence.

The Commission should treat this issue in the same manner that it treated the issue of the Must-Offer obligation, which was raised by several parties in their comments and protests concerning the May 13 Filing. In the July 1 Order, the Commission declined to rule on the issue of the appropriate treatment of the Must Offer obligation under MRTU because the issue was not raised in the CAISO's May 13 MRTU Filing. July 1 Order at P 165. Consistent with this decision, the Commission should not have ruled on issues regarding the granularity of load aggregation zones, given that such issues also were not raised in the May 13 Filing.

Even more troubling, from a procedural point of view, is the fact that the Commission's rulings in the July 1 Order depart from established precedent with no recognition of such departure, or explanation of why such departure is warranted. In the July 22 Filing, the CAISO proposed establishing three mandatory default load aggregation pricing areas for load scheduling, bidding and settlement: the PG&E transmission service territory; the SCE transmission service territory; and SDG&E transmission service territory. Therein, the CAISO also stated that it proposed to make

load aggregation mandatory, such that loads would not have the option to "opt-out" of the aggregation. Several parties challenged these proposals in comments and protests concerning the July 22 Filing, and the CAISO responded to those arguments. In the October 28 Order, the Commission accepted the CAISO's load aggregation proposal, finding that "the CAISO's approach to aggregate prices for load over the three existing service territories provides a reasonable and simplified approach to introduce locational marginal pricing ("LMP"), while minimizing its impact on load." October 28 Order at P 65.

In requiring the CAISO to disaggregate the three LAP zones corresponding to the service territories of the IOUs, and allowing customers to "opt out" of load aggregation by establishing their own separate LAP zones, the July 1 Order effectively overturns the Commission's ruling in the October 28 Order. Moreover, it does so with no recognition or discussion of the October 28 Order, or the reasons that the CAISO presented as to why three LAP zones are appropriate, and why customers should not be permitted to opt out of load aggregation. By failing to address either the October 28 Order, or the explanations provided by the CAISO supporting its proposals, the July 1 Order violates the well-established principle of administrative law that an agency must conform to its prior practice, policy or decisions or explain the reasons for its departure from precedent. *See, e.g.*, *United Municipal Distributors Group v. FERC*, 732 F.2d 202, 210 (D.C. Cir. 1984); *Greater Boston Television Corporation v. FCC*, 444 F.2d. 841, 852 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971) (agency must give reasoned analysis for departure from prior agency practice). The July 1 Order contains no explanation whatsoever as to why the Commission has now chosen to depart from its

rulings in the October 28 Order, or why the rationales provided by the CAISO underlying those rulings are no longer valid. Barring such an explanation, the Commission cannot overturn that decision. The Commission's rulings in the July 1 Order requiring the CAISO to disaggregate the LAP zones, and permitting customers to opt out of load aggregation, should therefore be reversed.

2. The Commission's Decision to Require the CAISO to Disaggregate the Currently Proposed LAP Zones is Premature

Based on the concerns raised by LECG and certain Market Participants with respect to the granularity of the LAP zones, the CAISO does not oppose exploring the possible creation of additional LAP zones beyond the three zones corresponding to the IOUs' service territories. However, the CAISO submits that the Commission's requirement that the CAISO disaggregate the three LAP zones is premature. The CAISO has not had an opportunity to investigate these concerns and discuss the issue with its stakeholders and consultants. Moreover, the CAISO is presently conducting, with the assistance of its consultants, LECG, a detailed Congestion Revenue Rights ("CRR") study whose results will be available during the Summer of 2005. This study will provide quantitative evidence concerning the impact of using LAPs corresponding to the service territories of the three existing IOUs on the availability of CRRs. After the release of this study, the CAISO had planned to share the results of this study with its stakeholders, and respond to and discuss any concerns raised by stakeholders concerning the granularity of the LAP zones. At that time, the question of whether disaggregation of the three IOU zones is necessary or desirable will be much clearer, and the CAISO will be in a far better position to present to the Commission a proposal that is based on substantial additional data and feedback from Market Participants and

LECG. At this point in time, however, there is no substantial evidence in the record either: (1) to support a ruling that three zones is the incorrect number, or (2) that more than three zones is appropriate. The Commission should not predetermine the outcome of this issue until such evidence becomes available and the CAISO has had the opportunity to discuss the issue further with stakeholders and identify the appropriate number of load zones. Therefore, the CAISO respectfully requests that the Commission reverse its decision to require the CAISO to increase the number of currently proposed LAP zones, and defer consideration of this issue until the CAISO has had an opportunity to complete its CRR study and discuss the results of that study with its stakeholders and consultants.

3. Allowing Participants to "Opt Out" of Load Aggregation Undermines the Fundamental Purpose of Load Aggregation, and Will Likely Result in Significant Cost Impacts to Consumers in Transmission Constrained Areas of the Grid

The CAISO continues to maintain that it is important to the overall LMP market design that Participants not be permitted to opt out of load aggregation. Permitting customers to opt out of load aggregation undermines the fundamental reason for instituting load aggregation in the first place – to blunt the potential for severe cost impacts to consumers in congested areas that exist as a result of constraints in a transmission system that was designed and constructed under an entirely different regulatory regime that did not anticipate competitive generation markets and nodal pricing. As the CAISO explained in the July 22 Filing, it is appropriate to prohibit Market Participants from establishing separate LAP zones upon implementation of LMP because it will preclude loads at low-priced nodes from opting-out and thereby raising the prices at the remaining nodes. This danger is particularly acute for entities serving

load in transmission-constrained areas of the grid, or "load pockets," such as the San Francisco Bay area. As the CAISO noted in its answer to comments and protests concerning the July 22 Filing, California was designed and constructed under an integrated utility industry structure and regulatory framework that never anticipated either locational pricing or the unbundling of the generation function of electricity from the transmission function. Under this framework, decisions to build transmission were based on the presumption that: (1) consumers would not be charged different rates based on the impact of transmission constraints, and (2) the integrated utility should plan investment in generation and transmission infrastructure in an integrated fashion, substituting one for the other as appropriate. As a result, the structure in certain areas of the grid unduly limits access by consumers in those areas to competitive supplies. Because of this structure, it would be patently unfair, upon changing the industry structure and regulatory framework, to subject consumers to the legacy of the prior rules, thereby preventing all consumers from realizing the benefits of competition. Requiring all Market Participants to participate in load aggregation will allow Market Participants to become comfortable with LMP and mitigate any concerns about the potential adverse impacts of nodal pricing. Moreover, precluding Market Participants from opting out of load aggregation would result in a simpler initial implementation for both scheduling and settlements, as well as a simpler initial CRR allocation.

B. The Commission Should Reverse its Decision to Eliminate Local Market Power Mitigation Measures for RUC Availability Bids

The CAISO's July 22, 2003 MRTU filing did not include a proposal to mitigate RUC Availability Bids because the CAISO proposed to pay a unit called upon to provide capacity under the RUC process (an "RUC resource") as-bid and to rescind the RUC

Availability Payment if an RUC resource is dispatched for energy in Real-Time. Thus, resources with market power (*i.e*., those most likely to be needed/dispatched) would not receive an Availability Payment if dispatched, thereby obviating the need to mitigate such units' Availability Bids.

The Commission, however, directed the CAISO to make certain modifications to the RUC design. First, the Commission required that RUC Availability Bids should set a market clearing price rather than be paid on as-bid basis. October 28 Order at P 123.[4] The Commission also rejected the proposal to rescind the Availability Payment if an RUC resource is dispatched. October 28 Order at P 124. These modifications to the RUC process create the potential for the exercise of local market power by units submitting RUC Availability Bids, thereby creating the need for effective local market power mitigation.

RUC capacity is procured to meet the CAISO's load forecasts in the event that day-ahead schedules are less than the CAISO's forecast. RUC capacity therefore must be deliverable to load on a nodal basis (*i.e*., it must be feasible within the full network model). In this respect, RUC capacity differs from Ancillary Service capacity, which is procured on a regional basis for contingencies. The need to procure RUC capacity on a nodal basis creates the same potential for units submitting RUC Availability Bids to exercise local market power as exists for units submitting energy bids. This market power must be mitigated in order to ensure that the Market Clearing Prices ("MCPs") established by RUC Availability Bids are not unjust and unreasonable because they are above the MCP level that could be justified in truly competitive markets that are not

[4] The Commission also rejected the proposed $100/MW cap on Availability Bids, setting the Availability Bid cap at the same level as the Ancillary Services bid cap. *Id.*

restricted by the presence of local system constraints. For this reason, the CAISO proposed in its May 13 Filing a very simple procedure to make RUC Availability Bids subject to local market power mitigation similar to energy bids. Transmittal Letter at 49-50.

No commenter opposed the CAISO's proposal to make RUC Availability Bids subject to local market power mitigation, although one commenter – Southern California Edison – expressed concerns about whether the CAISO's proposal was sufficient to mitigate the exercise of local market power in the RUC procurement process. *See* July 1 Order at P 134.

The Commission's July 1 Order rejected the CAISO's proposal to apply local market power mitigation to RUC Availability Bids. The July 1 Order states in relevant part:

> It is the Commission's understanding that RUC capacity should not need to be procured on a regular basis and, in fact, would rarely be necessary from non-resource adequacy resources as long as sufficient capacity is required through the resource adequacy mechanism. Rather than introducing such a complicated and intrusive process, the CAISO's concerns regarding gaming of RUC capacity may be more simply and effectively addressed through the CPUC's resource adequacy process.

July 1 Order at P 136.

Although the CAISO anticipates that much of its forward load forecasts will be met through capacity provided under Resource Adequacy capacity contracts or RMR contracts, there will be situations when the CAISO needs to procure RUC capacity from resources that are not subject to such contracts. Such situations can arise due to Resource Adequacy units within a particular region being forced out of service, transmission de-rates, or unusually high loads. While it is true that an LSE's exposure

to RUC Availability Costs can be limited by fully scheduling all of its forecasted load in the IFM, it is often not cost effective for an LSE to do so, particularly if there are opportunities to procure from lower cost supply sources that are not available until the hour ahead time frame. Thus, the Commission cannot assume that most or all of the RUC capacity requirements will be satisfied by Resource Adequacy capacity contracts.

Because local constraints will limit the number of resources available to satisfy the RUC requirements at a given node, the CAISO may be forced to accept an Availability Bid for non-RA capacity from a resource that can exercise local market power. The resulting RUC Market Clearing Price will be higher than the MCP that would be established in a truly competitive market. For the same reason that energy MCPs may be unjust and unreasonable without local market power mitigation, the Availability Payments made to all RUC resources receiving the RUC Market Clearing Price may be unjust and unreasonable without effective mitigation of local market power.

Moreover, while the Commission cannot rely on the CPUC's Resource Adequacy requirements to mitigate local market power in the RUC procurement process, the failure to mitigate local market power in RUC Availability Bids could have adverse consequences for Resource Adequacy capacity contracts. The lack of effective local market power mitigation for RUC Availability Bids may allow resources with local market power to force LSEs seeking to fulfill their Resource Adequacy Requirements into local capacity contracts at higher prices than could be justified in truly competitive markets. A resource considering whether to enter into a local capacity contract with an LSE will compare the revenue stream available under that contract to the revenue stream the

resource could receive if called upon under the RUC process. Absent effective mitigation of Availability Bids, an LSE may essentially have to "buy-out" the additional RUC Availability Payments that the resource could obtain through the exercise of local market power in order to get the resource to agree to forego the RUC Availability Payments by entering into a Resource Adequacy capacity contract. Therefore, the failure to mitigate local market power in RUC Availability Bids may force LSEs to enter into local capacity contracts at prices that are not just and reasonable (*i.e.*, at prices that would exceed those paid for such contracts to a resource that cannot exercise local market power).

Finally, the CAISO disagrees with the Commission's statement that the proposed mitigation of RUC Availability bids will be "complicated and intrusive." July 1 Order at P 136. The proposed local market power mitigation procedure for RUC Availability Bids is in fact quite simple – if a resource has its energy bid mitigated for local market power, its RUC Availability Bid will also be mitigated. This is a relatively straight forward procedure to implement with minimal computational burden and system impact.

In order to ensure that both RUC Availability Payments and Resource Adequacy contracts are just and reasonable, the Commission should reverse this aspect of the July 1 Order and approve the CAISO's proposed local market power mitigation of RUC Availability Bids as set forth in the May 13 Filing.

C. The Commission Should Clarify That the July 1 Order Does Not Preclude the CAISO From Including in its MRTU Tariff Protections That Will Make RA Units Ineligible to Receive RUC Availability Payments.

The CAISO requests clarification of a related discussion in Paragraph 136 of the July 1 Order. Under the CAISO's RUC proposal, capacity that is already receiving

compensation from LSEs to satisfy Resource Adequacy Requirements ("Resource Adequacy capacity" or "RA capacity") that is then procured through the CAISO's RUC process would not be eligible for the RUC Availability Payment.[5] The Commission did not expressly address this issue in the July 1 Order. However, in the discussion regarding local market power mitigation for RUC bids, there is language that suggests that such a restriction should be included in the CPUC's Resource Adequacy Requirements and not in the MRTU Tariff:

> Capacity obligations by sellers are to be handled through the CPUC resource adequacy requirements which could easily incorporate basic RUC bidding restrictions on "capacity suppliers" if the CPUC feels that such bidding commitments are necessary. For instance, suppliers of resource adequacy capacity could simply be required to bid zero for RUC capacity in the CAISO market as a condition of its resource adequacy agreement.

July 1 Order at P. 136. Another statement in the July 1 Order arguably could be read to require that capacity procured by LSEs to satisfy CPUC Resource Adequacy Requirements be eligible to receive RUC Availability Payments in some circumstances: "Additionally, the LSE that has procured the capacity could be eligible to receive any revenues that result from the sale of RUC capacity should the price ever exceed zero." *Id.*

The CAISO does not believe that these statements were intended to preclude the CAISO from including in its MRTU Tariff filing protections to ensure that RA units will not be eligible to receive RUC Availability Payments. Indeed, Commission action on this issue would be premature because this issue has not been fully vetted by stakeholders and because the Commission does not have a full record to consider this issue. The

[5] *See* MRTU White Paper at 11 ("RA capacity that is procured as RUC capacity would not be eligible for the RUC availability payment").

specification of Must Offer Obligations that would apply to RA capacity, including the rules associated with participation in RUC, is a subject still undergoing discussion in the CAISO's stakeholder process. The CAISO has therefore not submitted this issue to the Commission for conceptual approval, with the expectation that the CAISO's preferred resolution of all RA-Must Offer issues will be included in the November 2005 MRTU Tariff filing. The CAISO requests that the Commission clarify that the statements in the July 1 Order quoted above were not intended to presume or constrain the outcome of the ongoing stakeholder process, and that it will consider the CAISO's proposal in the context of the November 2005 MRTU Tariff filing.

In the event that the July 1 Order was intended to preclude the CAISO from including in its MRTU Tariff filing protections to ensure that RA units will not be eligible to receive RUC Availability Payments, the CAISO urges the Commission to reverse this aspect of the July 1 Order. Such a directive would be procedurally defective because it goes beyond the scope of the issues for which the CAISO requested conceptual approval in the May 13 Filing. Because the CAISO's proposal in the May 13 Filing did not address the reasons why RA units should not receive RUC Availability Payments, parties had no notice that it was appropriate or necessary to comment on these topics in pleadings submitted to the Commission concerning the May 13 Filing. Not surprisingly, most parties did not, in fact, address this issue in their comments on the May 13 Filing. By deciding this issue without giving parties, including the CAISO, a full and fair opportunity to present their views on this issue the Commission has deprived these parties of due process. Moreover, because parties did not have an opportunity to

comment on these issues, the Commission's decisions are the product of an incomplete record, and thus, cannot be said to be supported by substantial evidence.

In addition to the procedural defects, there are also compelling substantive reasons why the July 1 Order should not be read to preclude the CAISO from including in its MRTU Tariff filing protections to ensure that RA units will not be eligible to receive RUC Availability Payments. The CAISO strongly believes that a unit receiving payment for RA capacity should not also receive RUC Availability Payments for that capacity even if the RA capacity is not included in an LSE's day-ahead schedule and is instead called upon through the RUC procurement process. RUC Availability Payments and payments for RA capacity are essentially two different mechanisms of compensating a resource for the same service – providing capacity to satisfy forecasted load needs. Allowing a resource to receive both forms of compensation would result in an inappropriate double payment for the same capacity. While the CAISO does not read the July 1 Order to support such a double payment, in the unlikely event that Paragraph 136 could be read to require that a unit providing capacity to satisfy Resource Adequacy Requirements will also be eligible to receive RUC Availability Payments, the CAISO urges the Commission to modify this aspect of the order so as not to require double-payment to resources for providing a single service.

The CAISO also believes that the most appropriate way to prevent such double-payment is for the CAISO Tariff sections governing RUC Availability Payments to provide that units receiving payment for RA capacity will not be eligible to receive RUC Availability Payments. It is true that Resource Adequacy contracts could be designed to require unit owners to credit any RUC Availability Payments they receive back to the

LSE paying for RA capacity. Such a credit-back mechanism would be inefficient and needlessly complex. Specifically it would require the CAISO to provide information on RUC Availability Payments not only to the units receiving the payments but also to the LSEs entitled to the credit-back. The LSEs and Resource Adequacy unit owners will then need to determine which RUC capacity is associated with each LSE and incur the transaction costs associated with making the necessary contractual settlements.[6] The CPUC will also need to oversee this process as part of its implementation of the Resource Adequacy program. Conversely, it will be far simpler for the CAISO – which will already have information on which units are providing capacity to satisfy Resource Adequacy Requirements – to refrain from making RUC Availability Payments to Resource Adequacy units in the first place.

For the foregoing reasons, the CAISO requests clarification that provisions ensuring that RA units will not receive RUC Availability Payments can be included in the November 2005 MRTU Tariff filing. To the extent that the July 1 Order constitutes a directive that such protections against double payment should be included in the CPUC Resource Adequacy Requirements and *should not* be included in the CAISO's November 2005 MRTU Tariff filing, the CAISO requests that the Commission reverse

[6] Determining the correct amounts for such contractual settlements will not necessarily be straightforward and unambiguous. For example, suppose a 300 MW unit is providing 300 MW of RA capacity to three LSEs at 100 MW each. On a particular day in a particular hour, the unit clears the forward energy market at 200 MW and is awarded RUC capacity for 100 MW at a price of $20/MW. In such a situation, one would have to determine the appropriate method to credit back the RUC payment of $2,000 to the three LSEs. One approach would be to credit it back in proportion to their contracts (*i.e.*, each LSE receives a third). However, this would hardly be fair if only one of the LSEs had actual RUC cost exposure (i.e., the other two were fully scheduled in the IFM). Another approach is to allocate the RUC payment back to the LSEs in proportion to their actual RUC cost exposure, but this would require that the RA unit owner receive information from the LSEs on their RUC cost exposure. It is not clear how such information would be verified. More fundamentally, there would still be a question as to how one would associate an LSE's RUC cost exposure in a given hour with a particular RA resource. These are complexities that would not have to be addressed if there was a provision in the CAISO Tariff that RA units are not eligible to receive an RUC Availability Payment.

this aspect of the July 1 Order and permit the protections to be included in the MRTU Tariff. As discussed above, because the CPUC intends to issue an order on its Resource Adequacy Requirements in October of this year, the CAISO requests that the Commission act on this Request by no later than September 30. This will allow the CPUC to adequately address the issue in the event the Commission rules that the issue should be addressed as part of the Resource Adequacy program and not in the CAISO Tariff.

D. The Commission Should Clarify That the Solution to the Problem of Settling Intertie Bids Proposed in the CAISO's Recent Filing in the Amendment No. 66 Docket May Be Temporary, and That a More Permanent Solution to this Issue Will Be Developed Through the MRTU Stakeholder Process and Implemented as Part of HASP in February 2007

In its discussion of HASP in the July 1 Order, the Commission noted that several parties had filed comments regarding whether HASP would adequately address the intertie scheduling problems that led to the CAISO's Amendment No. 66 filing. The Commission also stated that the CAISO was considering various options as part of a stakeholder process in the Amendment No. 66 proceeding, and would be filing its proposed long-term solution to address the intertie scheduling problems in the Amendment No. 66 docket.

The CAISO requests clarification that the Commission, in referring to the long-term solution that the CAISO filed in the Amendment No. 66 docket on July 26, 2005 ("July 26 A66 Filing"), did not intend that the ISO would necessarily continue to use that solution when the ISO implements HASP as part of MRTU Release 1 in February 2007. As the CAISO noted in the July 26 A66 Filing, the CAISO intends the solution presented therein to be a temporary, "longer term," solution, to be effective until February 2007,

when the CAISO implements MRTU Release 1. The reason for this is that the "longer term" solution for settling intertie bids filed in the Amendment No. 66 docket is the best option given the ISO's current software constraints. Although the CAISO believes that a different solution may be preferable in the long run, in particular one in which intertie bids are settled based on a pre-dispatch market clearing price, the CAISO would require at least six months in order to implement such a solution. However, because the CAISO will be replacing its software in connection with the implementation of HASP in February 2007, the CAISO expects to be in a position to adopt an alternative solution as part of that implementation, if it determines that such an alternative is preferable to the current "as bid" methodology. Therefore, the CAISO plans to explore with its stakeholders the issue of which intertie settlement solution will be the best option under HASP, whether it be the current "as bid" methodology or an alternative methodology, and to file the preferred solution as part of its MRTU Tariff filing, to be made in November 2005. The CAISO thus respectfully requests that the Commission clarify that the methodology for settling intertie bids recently filed in the Amendment No. 66 docket may only be a temporary solution to this issue, to be effective until the CAISO implements HASP in February 2007, and that a long term solution to be implemented as part of MRTU Release 1 will be developed through the MRTU stakeholder process.

E. The Commission Should Clarify That the CAISO Is Not Required to Calculate the Incremental Costs of Using Bid Adders In Calculating LMPs and Then to Allocate These Costs to LSEs Based On Their Share of Under-Procured Capacity

The CAISO seeks clarification with respect to the Commission's determination on the use of bid adders for Frequently Mitigated Units ("FMUs"). Specifically, in

Paragraph 144 of the July 1 Order, the Commission concluded that the CAISO's proposal to compensate FMUs through the use of a bid adder was reasonable. However, the Commission noted that it shared the CPUC's concerns regarding cost allocation and stated that it understood "that where capacity is procured by the CAISO due to failure of specific LSEs procuring their locational requirements, the CAISO will allocate these costs to LSEs based on their share of under-procured capacity." July 1 Order at P 144.

The CAISO seeks clarification that the Commission does not expect the CAISO to determine the incremental costs of using bid adders as part of its calculation of LMPs, and then impose these incremental costs on LSEs "based on their share of under-procured capacity." *Id*. Consistent with the PJM approach, the CAISO will allow bid adders to be applied to a unit's Default Energy Bid, and allowed to set LMPs. As a result, the costs of bid adders arise directly from the settlement of LMPs. If the payment of bid adders results in very high LMPs within a particular load region, all load scheduled within that region will, as a result, be subject to the high LMPs, including any load covered by a local capacity contract with generation within that region. However, an LSE could minimize its exposure to such high LMPs by supplementing its local capacity contract with a long-term fixed price energy contract. Doing so would provide a hedge against potentially high LMPs due to the use of bid adders or other circumstances. There is no valid reason to treat the CAISO differently than PJM on this issue, and the Commission has not enunciated any reasons for doing so. Because the Commission found that the CAISO's proposed market power mitigation "mirrored PJM's approved market design package" and approved the CAISO's LMP measures as such

(July 1 Order at P 122), presumably the Commission intended to approve this aspect of the proposal that also mirrors PJM.

It would be extremely complicated for the CAISO to calculate the incremental costs of using bid adders on LMPs, and then allocate those incremental costs such that those costs would only apply to LSEs that have under-procured capacity. This would require performing two pricing runs of the market, one with and one without bid adders, and allocating the incremental cost of the second run to LSEs that have under-procured capacity. The additional data and settlement procedures necessary to perform these calculations would significantly increase the cost and complexity of the MRTU design. Moreover, the CAISO does not believe that such a cost allocation scheme would be just and reasonable as the incremental cost of applying the bid adder could be very high relative to the level of an LSE's under-procurement. For example, a 10 MW Direct Access LSE that failed to meet its relatively small local capacity obligation could be allocated the entire incremental cost of a $50 increase in LMPs, due to the payment of a bid adder, that is applied to 1,000 MW of load (*i.e*., all load in the load region with LMPs that is impacted by the bid adder). Such a result violates the cost-causation principle that appears to underlie the Commission's understanding of this issue. Therefore, the CAISO submits that it would be unjust and unreasonable to allocate the costs of bid adders imposed on LSEs based on their share of under-procured capacity, and requests that the Commission clarify that the CAISO will not be required to do so.

The CAISO, nevertheless, could potentially address the Commission's underlying goal of allocating capacity costs based on responsibility for incurring those costs in the context of local capacity contracts. In the May 13 Filing, the CAISO noted that it

planned to develop, as rapidly as possible, a local capacity contract for Frequently Mitigated Units not under an RMR or resource adequacy contract to replace or serve as an option to the bid adder. If the CAISO develops that contract, it could allocate the costs associated with the contract in a manner that reflects these principles of cost causation, while at the same time ensuring that Market Participants are not unfairly saddled with costs out of proportion to their level of participation in the CAISO's markets.

F. The Commission Should Clarify that the CAISO Is Not Required to Include RUC Self-Provision in Its November 2005 MRTU Tariff Filing if the CAISO Concludes, Based on Stakeholder Input, That RUC Self-Provision Should Not Be Included in MRTU Release 1.

In response to stakeholder comments, the CAISO developed a conceptual proposal for RUC self-provision, whereby LSEs that want to schedule less load in the Day-Ahead market than their forecasted load for the next day would be able to self-provide RUC capacity rather than rely on the CAISO's RUC procedure to procure such capacity and be subject to RUC cost allocation. This proposal was submitted for Commission consideration in May 2004. The Commission's June 17, 2004 order accepted the CAISO's conceptual proposal and directed the CAISO "to address the functional concerns raised by intervenors as well as any other issues through the stakeholder process." *California Independent System Operator Corp.*, 107 FERC ¶ 61,274 at P 57 (2004) ("June 2004 Order"). As the June 2004 Order suggests, RUC self-provision is a market feature that has been developed primarily in response to stakeholder requests and has not been identified by either the Commission or the CAISO as an essential feature of the MRTU market design.

RUC self-provision has been designated as a Category B issue currently under discussion with stakeholders for consideration as part of the November 2005 MRTU Tariff filing. The July 1 Order notes that this issue is under discussion in the stakeholder process and goes on to state that, "We therefore expect the CAISO to include the RUC self-provision feature in its tariff filing in November 2005. At such time we will entertain parties' comments on the issue of RUC self-provision." July 1 Order at P 181.

Based on recent stakeholder input, it is apparent to the CAISO that most if not all stakeholders now do not believe that the RUC self-provision feature is needed as part of MRTU Release 1. The CAISO therefore requests clarification that it has the flexibility to elect not to include RUC self-provision in the November 2005 MRTU Tariff filing if the CAISO concludes, based on stakeholder input, that this feature should not be included as part of the final MRTU Release 1 market design.

V. CONCLUSION

Wherefore, for the reasons discussed above, the CAISO respectfully requests that the Commission clarify and grant rehearing of the July 1 Order as requested above.

Respectfully submitted,

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Dated: August 1, 2005

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 1st day of August at Folsom in the State of California.

/s/ Charity N. Wilson
Charity N. Wilson