Comments of the California Department of Water Resources' State Water Project on the California Independent System Operator's Congestion Revenue Rights Issues

April 6, 2007

The California Department of Water Resources' State Water Project (SWP) appreciates the California Independent System Operator (CAISO) providing entities the opportunity to present comments on the CAISO's CRR Issues that were presented in stakeholder conference calls (March 23rd, 26th, 27th and 29th), meetings (April 3rd and 4th), the March 19th "Updated CRR Issues" whitepaper, and related whitepapers listed below.

The CAISO asked entities to submit final comments on the above issues by April 6, 2007. The following are the SWP's comments:

1. CRR Allocation Rules (based on March 19th "Updated CRR Issues" whitepaper)

1.1 Source Nominations at Trading Hubs

- The SWP supports the allowance of Trading Hubs as source nominations for LT-CRRs and the CAISO's proposal of source nomination limits (Option 1 of the March 19th "Updated CRR Issues" whitepaper) provided that the source and sink limits are matched for each tier. For reference please see initial SWP's comments on the CRR Issues submitted to the CAISO on March 9th 2007.
- The SWP opposes Options 2 and 3. The EZ Gen Disaggregation proposal (Option 2) would introduce implementation complexities, including uncertainties, beyond the scope of the CRR production timeframe. EZ Gen Hubs + Alt Hubs (Option 3) would also require an extensive stakeholder process to define the Alt Hubs.

1.2 Set-aside of Import Capacity on Each Inter-tie for CRR Auction

- The SWP, although opposed to any increase in the set-aside for auction purposes, recognizes that the set-aside of import capacity is an attempt to provide suppliers with a reasonable amount of inter-tie CRRs while preserving the CRR primary purpose of providing market participants that have long-term load obligations, particularly LSEs, with the ability to hedge the congestion costs of serving their load. The SWP supports retaining the current 50% set-aside rule, noting that future allocation and set-aside amounts based on the historical period 2006 would, regardless of stakeholder interests, more accurately reflect the scheduling needs of LSEs to serve their load.

1.3 New Alternative – Reserving Grid Capacity for Auctions

- The SWP opposes the "New Alternative" proposal recently introduced to stakeholders in the April 3rd meeting. The SWP understands that CAISO is proposing this alternative as an attempt to ensure that set-aside quantities will be available for auction, however, the SWP believes that, in conjunction with the limited timeframe prior to CRR production and the further erosion of meaningful

Dry Run results at the cost of a new replacement for set-aside, the set-aside quantities can be ensured through either continuance or *modification* of the current set-aside rule. Additionally, the SWP does not support the deration of all grid capacity for the sole purpose of addressing set-aside amounts at inter-ties.

1.4 CRR Source Verification Rules

- Regarding the issue of allowing sources with contracts signed prior to 1/1/07 for delivery at a future date, the SWP recommends that the CAISO consider these types of contracts for an LSE's Seasonal CRR allocation source verification only if the respective LSE had similar types of power contracts prior to 1/1/07. If the historical data does not include these types of contracts, the LSE has to respect the present MRTU Tariff rules and request CRRs only in the Tier 3 of the Seasonal CRR Allocation (when no source verification is required) and in the Tier 1 and 2 of the Monthly CRR Allocation (when the LSE may nominate CRR based on the forecasted load and sources data).
- The SWP supports retaining the current minimum 1 month contract term rule and opposes changing the rule to allow less than one month term contracts, specifically since these contracts (i.e. one day) accounted for a small percentage in the Dry Run, do not necessarily verify a need to serve load, will require more administration on both the LSE's and CAISO's part, and, if the "spot check" method is proposed, will require the CAISO to adopt contract "default" and compliance policies should the spot check find an unverified contract in the list of contracts.
- The SWP supports retaining the current monthly source verification rules, if not more, and opposes any proposal to decrease the verification rules.

1.5 Renewal of Expiring LT-CRR and ETC/CVR

- The SWP appreciates the CAISO proposal to allow the LSEs with expiring Existing Transmission Contracts (ETCs) to nominate LT-CRR in the year following the expiration of the LSE's ETCs. In an e-mail to CAISO, dated 02/14/07[1], SWP presented to the CAISO's LT-CRR team the possible negative

[1] The following e-mail was sent to Lorenzo Kristov on 02/14/07: The SWP concern is that once the SWP's ETC with the PG&E will expire in 2014, the SWP would face competition in the 2015 LT-CRR Allocation from PG&E and other LSEs in the PG&E Control Area. The attachment describes a short example of a scenario that may happen in year 2014 when CAISO will allocate LT-CRRs for year 2015.

On the January 9th, 2007 CAISO's LT-CRR conference call, I presented the above issue. Then, I proposed that the LT-CRRs that the CAISO owns (for the ETCs holders' "perfect hedge" CAISO requests internally LT-CRRs) should be turned over to the ETC holders when the ETC will expire. In our case, the CAISO would request internally LT-CRRs to "perfect hedge" SWP's ETC with PG&E for the 2008-2017 period. Since the above mentioned ETC expires on December 31st, 2014, for the 2015-2017 period, the LT-CRRs owned by the CAISO based on the SWP's ETC with PG&E should be turned over to the SWP. Using the above described LT-CRR turn over model for LSEs with expiring ETCs will ensure that such LSEs would eliminate the unfair competition that may result from the present LT-CRR design presented in the attachment.

outcomes of the LT-CRR nominations for a LSE with expiring ETCs. The SWP's example, presented in the previous mentioned e-mail, is to some extent similar to the CAISO's example presented on pages 23-25 of CAISO's March 19, 2007 "Updated CRR Issues" whitepaper. To fix the negative outcomes, SWP proposed that, for a LT-CRR allocation following ETC expiration date, the CAISO's internally requested LT-CRRs (requested to provide the "perfect hedge" to the ETC holders) should be turned over to LSEs as their ETCs become expired.

2. CRR Credit Policy (based on March 20th "CAISO CRR Credit Requirements" whitepaper)

The SWP will provide minimal comments at this time, noting that the CAISO has released a revised April 6th whitepaper on this subject. The SWP generally supports the CAISO's proposed principles of CRR Credit Policy but will reserve additional comments after review of the revised proposal.

Attachment;

PG&E Control Area

	SWP	PG&E
Total load (MW)	1,000	20,000
LT-CRR TEQ for 2008-2014	0*	10,000
LT-CRR TEQ for 2015-2017	500	10,000

* CAISO will request internally 500 MW LT-CRRs to "perfect hedge" SWP congestion costs

Scenario that may happen for the 2015 LT-CRR Allocation

In September 2014 the PG&E renewal for the LT-CRR will be only for the 8,000 MW. With 2,000 MW LT-CRR entitlement left, PG&E will compete with SWP on the 500MW of available LT-CRR (if the PG&E and SWP sinks are at the same location; no source validation required).

		Requested		Allocated	
		PG&E	SWP	PG&E	SWP
Total LT-CRR Table Mountain to Midway	500	2,000	500	400	100

3. Methodology for Determing CRRs for Merchant Transmission Upgrades (based on March 23rd "Methodology for Determining CRRs for Merchant Transmission Upgrades" whitepaper)

- The SWP will provide minimal comments at this time, noting that the CAISO has released a revised April 6th whitepaper on this subject. The SWP generally supports the CAISO's proposed principles of Merchant CRRs but will reserve additional comments after review of the revised proposal.

4. Other Comments

- A significant number of CRR issues have been presented by the CAISO for stakeholder review and comment over the past month, specifically in preparation for the CRR production run. The SWP points out that any new proposals at this time that would significantly change current rules or require more time (and that the CAISO cannot conclude as representative of stakeholder majority opinion) should either be reserved for later or be used only as a last resort if current rules cannot be modified to satisfy the CRR production run.
- The SWP takes this opportunity to remind the CAISO that SWP will continue to provide maximum cooperation and participation in the CAISO's Stakeholder process in which CAISO and Market Participants are trying to model CRRs and other issues omitted in the February 9, 2006 filing to FERC. However, SWP believes that the CAISO is not responding with the same level of cooperation and participation in developing MRTU Tariff language for issues that, once implemented, will negatively impact SWP Operations. As an example, for the treatment of the ETCs under the CAISO's MRTU design, in the February 9, 2006 filing, the CAISO had not mentioned that the ETC owners could not use their ETCs for non-physical schedules (including SWP schedules at EZGTH). A few months ago, when the CAISO realized that this issue had not yet been addressed in the MRTU Tariff, the CAISO solely decided to not allow ETCs to be used for non-physical schedules. CAISO does not understand that at present, SWP Operations include, to a very large extent[2], power purchases at NP15, ZP26, and SP15 (which CAISO proposes to migrate to EZGTH NP15, EZGTH ZP26, and EZGTH SP15 under the MRTU design) for which the SWP uses, for all the transmission needs in the PG&E Control Area, the SWP's ETC with PG&E. CAISO also forgot that the FERC order on designing new energy markets states that the CAISO's MRTU design has to respect the ETC rights that were in place prior to the MRTU Implementation. SWP does not understand how the ETC rights are respected since in the CAISO's present energy market SWP can use its ETCs for non-physical energy schedules at NP15, ZP26, and SP15, and under the MRTU the same ETCs cannot be used for non-physical energy schedules at corresponding EZGTHs.

[2] In the PG&E Control Area, between 2005-2006, SWP purchased up to 75% of its energy needs at either NP15 or ZP26. Similarly, in the SCE Control Area, for the same period, up to 75% of the SWP energy needs were purchased at SP15.