

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

Wholesale Competition in Regions) Docket Nos. RM07-19-000
with Organized Electric Markets) AD07 -7 -000

COMMENTS OF THE CALIFORNIA ISO

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In response to the Advanced Notice of Proposed Rulemaking issued June 22, 2007, the California Independent System Operator Corporation (“CAISO”) respectfully submits the following comments.

I. INTRODUCTION

The CAISO appreciates the Commission’s efforts to improve wholesale competition and organized power markets. The CAISO has relatively few comments on the proposals in the ANOPR. The reason is that the CAISO has, through an iterative process, already implemented many of them. These measures, together with other CAISO processes and structures, are working extremely well to achieve the goals established by the Commission – *i.e.*, independent governance, responsiveness to stakeholders, and effective market monitoring.

In addition, and consistent with the “balanced and flexible approach”¹ advocated by the Commission, the CAISO would prefer to maintain the present structures for its market monitoring unit (MMU) and overall corporate governance. The CAISO’s existing structures and rules serve the purposes articulated in the ANOPR.

As a separate matter, the CAISO does not believe that the Commission’s orders currently require an MMU to report tariff or other violations by the ISO or RTO itself. It would be a mistake to adopt such a requirement.

¹ ANOPR ¶ 108.

The reasons for all of this are explained below.

II. COMMENTS

A. “Market Monitoring Policies” (¶¶ 95-132)

1. Requiring MMUs to Report to the Board

The CAISO supports FERC’s goal that MMUs should be both “independen[t]” and “accountable.”² The CAISO achieved this in 2005 by realigning so that its market monitor now reports directly to the CEO, instead of up through the General Counsel. At the same time, direct access to the CAISO’s Board of Governors is assured. The market monitoring report is a standing item on the agenda of the Board of Governors. All recommendations and reports from the market monitor go to the board, with treatment akin to reports from independent financial auditors – *i.e.*, management has no liberty to revise or change the substance, only to provide additional comment. The reports include candid assessments of operations performance,³ as part of the department’s responsibility to independently monitor and report on potential detrimental impacts that any CAISO operational practices may be having on market outcomes.

Organizationally, the MMU reports to the CEO. This reporting relationship ensures that the CEO is attuned to the needs of the MMU, and

² *Id.*

³ Additionally, the CAISO Board of Governors receives an independent audit of operations performance which, when finalized, is also made available to stakeholders.

that the other lines of the organization are committed to support the function of the independent monitor. It is also more practical than reporting directly to the board, which meets less than once a month and thus is not ideally suited for day-to-day supervision of staff.

The CAISO Market Surveillance Committee provides an additional layer of independence to ensure that problematic market design elements or operational practices are identified and discussed in an open and independent manner. The MSC is a blue-ribbon panel of independent experts that serves as a formal advisory committee to the Board of Governors. Its members review market performance, advise the market monitoring unit and perform peer review of its work, thereby providing another check against improper interference. The MSC can share any concerns it has with the board, and even go directly to the Commission.⁴

For all of these reasons, the CAISO recommends that any rulemaking permit it to retain the its current arrangement whereby the MMU reports directly to the CEO.⁵

⁴ See CAISO Tariff, Appendix P, §2.2.6.3.1.

⁵ The Commission is aware that the proposed requirements approach the outer boundaries of its authority. Cf. ANOPR ¶ 113; *see also California Independent Sys. Operator Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004). The court's decision is aptly summarized on FERC's "RTO-ISO Handbook": "On June 22, 2004, the U.S. Court of Appeals for the District of Columbia held that the Commission has no authority to dictate the governing structure of an ISO." <http://www.ferc.gov/industries/electric/indus-act/rto/handbook/CAISO/1-governance.doc>.

2. “Structure and Tools” (¶¶ 109-111)

The CAISO would not object to mandating that an ISO “provide its MMU with access to market data, resources, and personnel sufficient to enable the MMU to carry out its functions.”⁶ The CAISO tariff contains such a provision.⁷

The CAISO, however, asks the Commission to exercise care in defining a proposed corollary requirement “directing the MMU to report to the Commission any concerns it has with inadequate access to market data, resources, or personnel”⁸ A market monitor certainly should have access to Commission staff to share concerns on any subject. But requiring the monitor to report to the Commission any concerns about inadequate resources – as opposed to concerns about access to data and personnel, which the CAISO agrees should be reported promptly – goes too far.

Every critical function of an ISO must have the resources needed to perform its mission, because any failure can have a major impact on grid security, safety, or efficiency. Allocating resources to these functions presents a typical challenge of organizational efficiency where the budgeting

⁶ ANOPR ¶ 111.

⁷ Appendix P § 1.3.3.2 reads:

The ISO, through its CEO and Governing Board, shall determine that the Department of Market Analysis has adequate resources and full access to data and the full cooperation of all parts of the ISO organization in developing the database necessary for the effective functioning of the Department of Market Analysis and the fulfillment of its monitoring function.

⁸ ANOPR ¶ 111.

process must impose discipline on all programs to optimize performance at the lowest possible cost. In this respect, requiring the market monitor to report any concerns about inadequate resources is too low a threshold. Instead, the market monitor should be asked to report only those concerns that would significantly impair the monitoring unit's ability to satisfy regulatory requirements.

3. Requiring MMUs to Report Tariff Violations by the ISO

The ANOPR states that a market monitor might be obligated to report tariff violations by the ISO.⁹ The proposition is a “matter[] germane to market monitoring”¹⁰ that merits comment. The the CAISO does not believe that this is a current directive from the Commission. In contrast to most similar statements in the ANOPR, the statements on this subject are unaccompanied by a citation to previous orders or issuances. Although Commission's Policy Statement on Market Monitoring Units has stated that market monitors should report “all” violations,¹¹ nothing in that document suggests that the requirement extends beyond violations by market participants.

It would be a mistake to adopt any such requirement. To begin with, it would be unnecessary, because several controls on compliance are already in

⁹ See ANOPR ¶¶ 112, 115.

¹⁰ ANOPR ¶ 132.

¹¹ Policy Statement on Market Monitoring Units, May 27, 2005, Appendix A, Protocol No. 1.

place. Foremost is the Commission's recently-enhanced penalty authority, which provides a powerful incentive to self-report violations.¹² Beyond that is the commitment to compliance of CAISO management, as demonstrated by the creation in 2005 of the internal audit department, annual SAS 70 audits, and a requirement that all employees receive annual training on the CAISO Code of Conduct.

The additional compliance value, if any, that the Commission might gain from deputizing the market monitors would be insufficient to justify the additional burdens this would place on the monitor. The primary functions of an MMU are to evaluate market behavior in order to detect potential anticompetitive or otherwise prohibited behavior by market participants, and to identify ineffective market rules or tariff provisions. This focus will be diluted by adding the responsibility to report tariff violations by the ISO.

Such a reporting responsibility would also hinder the MMU's ability to perform the other functions effectively, because a market monitor necessarily relies on information from other parts of the organization. When evaluating a potential bidding or scheduling practice, market monitoring personnel can only make an educated guess about the impact of the practice on, for example, grid reliability. A complete understanding requires a discussion with the grid operations department. These are currently routine informal communications, which benefit both the market monitor and the operations side. These communications would become more formal, and thus could not

¹² See Policy Statement on Enforcement, October 20, 2005, ¶ 20.

be as efficient or candid, if the monitoring unit were required to act as a department of internal affairs.

For all of these reasons, the Commission should not adopt a rule that market monitors must refer violations by the ISO or RTO.

4. “Mitigation and Operations” (¶¶ 117–119)

The CAISO has no strong view on the Commission’s proposals that “operational activities affecting the market, including mitigation, are more properly performed by the RTOs and ISOs themselves . . .” and that MMUs should be required to “refrain from assisting the RTO or ISO in tariff administration.”¹³ The CAISO, however, requests clarification of where the Commission would assign the functions of mitigation (including the calculation of reference bids for generating units¹⁴) and administration of tariff-mandated penalties. In previous orders, the Commission has directed that these functions must be performed by independent entities.¹⁵ Since then, however, the Commission has found that the CAISO’s governance is sufficiently independent to be trusted with some of these decisions.¹⁶ To provide clear direction, the Commission should either clarify that these functions now may be performed by employees reporting to ISO management,

¹³ ANOPR ¶ 119.

¹⁴ See CAISO Tariff § 27.1.1.6.1.

¹⁵ See, e.g., California Independent System Operator Corp., 106 FERC ¶ 61,179 (2004), ¶154 (regarding enforcement of tariff-specified sanctions).

¹⁶ See California Independent System Operator Corp., 112 FERC ¶61,010 (2005) (granting declaratory order approving board selection process).

or else reaffirm that these functions must be performed by independent entities.

5. “Ethics” (¶ 120)

CAISO corporate policy specifically prohibits employees and full-time contractors from holding securities issued by market participants. In addition, it generally prohibits conflicts of interest. These rules apply to all market monitoring personnel. The tariff imposes similar restrictions on members of the Market Surveillance Committee.¹⁷ With that said, the CAISO would not object standard tariff provisions for all market monitors.¹⁸

6. “Tariff Provisions” (¶ 121)

The CAISO would not object to a mandate that “each RTO and ISO set forth all its provisions involving market monitoring in one section of its tariff.”¹⁹ The CAISO would consider consolidating Appendix P of its tariff with the relevant provisions in Section 38, and moving any other provisions that the Commission believes are misplaced.

7. “Information Sharing” (¶¶ 122–130)

The ANOPR proposes that, after a lag of three months, ISOs should post offer and bid data without the identification of market participants, and “solicit[s] comments as to whether that time period is sufficient to protect

¹⁷ See CAISO Tariff, Appendix P, § 2.2.2.2.

¹⁸ Cf. ANOPR ¶ 120.

¹⁹ ANOPR ¶ 121.

commercially sensitive data and to guard against misuse of the data.”²⁰ The CAISO Department of Market Monitoring believes that the proposed three month lag would be sufficient.

The CAISO has no comment on the other matters discussed in this section.

8. “Pro Forma Tariff Section” (¶ 131)

Subject to the concerns raised above under the headings of “Oversight” and “Functions,” the CAISO agrees that it would be useful for the Commission to propose a pro forma MMU section for OATTs of ISOs.²¹

To the extent this pro forma tariff section includes protocols for referral of tariff and manipulation violations to the Office of Enforcement, the CAISO suggests that the Commission clarify the policy statement about which matters should be referred. Protocol No. 1 currently states that

An MMU should make a referral to the Commission in all instances were the MMU has reason to believe that a Market Violation may have occurred. While the MMU need not be able to prove that a Market Violation has occurred, the MMU should provide sufficient credible information to warrant further investigation by the Commission.²²

While that formulation is fine as a statement of policy, any tariff language should be more explicit about the Commission’s expectation that MMUs will exercise discretion. In particular, the CAISO understands that MMUs are

²⁰ ANOPR ¶ 127.

²¹ *Cf.* ANOPR ¶ 131.

²² Policy Statement on Market Monitoring Units, issued May 27, 2005, Appendix A.

expected not only to prioritize its investigations according to the potential impact on the markets, but also to judge credibility and avoid referring cases for which there is not sufficient evidence of a violation.

B. “Responsiveness of RTOs and ISOs” (¶¶ 133-163)

1. “A Responsive RTO or ISO Board of Directors” (¶¶ 147-155)

The CAISO agrees with “the Commission’s preliminary conclusion . . . that representatives of customers and other stakeholders must have some form of effective direct access to the board of directors.”²³

CAISO board meetings are open to the public; only discussions of litigation, personnel issues, and limited confidential matters are held in executive session. To facilitate stakeholder involvement, agenda are released to the public several days ahead of meetings. The agenda include a comment period for any member of the public, including those expressing “minority views.” Stakeholder access was recently enhanced when the governing board meetings were restructured to enable stakeholders to speak on each decisional item after the management presentation and before the board’s decision. This opportunity is in addition to any written stakeholder comments, which are provided in summary form to board members in advance of the meeting along with the memoranda on each item.

The CAISO’s board structure has been dictated by state law since

²³ ANOPR ¶ 148.

2001.²⁴ In 2005, the Commission approved a selection process for CAISO board members that incorporates a 36-member board nominee review committee of stakeholders.²⁵ This process was implemented during the 2006 process to fill two vacant seats, when the top two candidates identified by this stakeholder group were appointed by the Governor. The CAISO's experience with a fully independent board has been good.

This stands in sharp contrast with the CAISO's experience with a stakeholder board. While the Commission can say that "[s]takeholder members must not be allowed to serve their own interests inappropriately,"²⁶ experience shows that this ideal can deteriorate when the stakes are highest. For example, in late 2000, the Commission found that

[O]ver the course of this summer, it has become apparent that the Governing Boards are not functioning as they were intended to. . . . we have no choice to conclude but that the existing California ISO stakeholder board is ineffective and must be modified.²⁷

According to a staff report from the same period, "[t]he stakeholder boards . . . are becoming widely perceived as too easily influenced by local political pressure."²⁸ "There appears to be unanimous support among the parties for

²⁴ See, generally, *California Independent Sys. Operator Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004).

²⁵ See *California Independent System Operator Corp.*, 112 FERC ¶61,010 (2005).

²⁶ ANOPR ¶ 152.

²⁷ E.g., *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange*, 93 FERC ¶ 61,121, 61,363-64 (2000).

²⁸ Staff Report to the FERC on Western Energy Markets and the Causes of the Summer 2000 Price Abnormalities, November 1, 2000, p. 6-18.

disbanding the current ISO Governing Board and replacing it with a non-stakeholder board.”²⁹

The CAISO does utilize stakeholder advisory groups as noted below, but believes that these groups are most effective when formed around a specific initiative, versus formed as standing committees. Formation of advisory groups around specific initiatives also makes more efficient use of the limited time of senior stakeholder executives.

2. RTO and ISO Executive Management Practices (¶¶157-159)

The Commission asks whether reforms are “necessary to increase management responsiveness to stakeholder concerns.”³⁰ The CAISO strives to be as responsive as possible. Earlier in 2007, the CAISO adopted a five-year business plan³¹ in which “Enhanc[ing] Customer Service” is one of six strategic objectives. This objective is supported by detailed initiatives intended to:

- Integrate customer care into the corporate culture
- Provide tools and information products increasing the transparency of operations
- Focus corporate effort on customer-driven initiatives and related measures of success.

²⁹ San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange, 93 FERC ¶ 61,294, 62,012 (2000).

³⁰ ANOPR ¶ 159.

³¹ The five-year business plan is available on the CAISO website at <http://www.caiso.com/1bfc/1bfca8ea547d0.pdf>.

Whether these efforts are succeeding is best judged by the stakeholders themselves. When considering the comments from CAISO stakeholders, the Commission may find it helpful to know that the CAISO has already implemented most of the proposals in the ANOPR. Specifically, the CAISO “publish[es] a strategic plan that includes plans for assuring responsiveness to customers and other stakeholders,” “measure[s] . . . customer satisfaction periodically through a survey,” “set[s] performance criteria for executive managers based in part on responsiveness to stakeholders,” and “relates executive compensation to a measure of responsiveness to stakeholders.”³² Customers receive surveys annually asking them to rate CAISO performance. The incentive compensation program for all employees – management included – contains two specific goals regarding stakeholder responsiveness, one for improving stakeholder processes and another for responding to stakeholder inquiries in a timely manner.

With respect to a “formal process for gathering and evaluating recommendations for improving services to customers,” *id.*, the CAISO supports the concept of stakeholder advisory groups but prefers using focused groups for specific topics on an as-needed basis, as opposed to a standing committee approach. Two instances in the past twelve months illustrate. In one case the CAISO formed a stakeholder advisory group to assist in developing communications and readiness plans for MRTU. In the second, the CAISO sought advice from stakeholder executives in development of the

³² *Id.*

five-year strategic plan.

3. Effective RTO and ISO Stakeholder Processes (¶160-161)

The Commission also seeks comment on how to improve stakeholder processes.³³ The CAISO uses stakeholder processes to elicit the views of customers and stakeholders and facilitate discussion, but not to vote on particular issues. The CAISO does not support formalized committees or complex voting structures.

In addition, the Commission asks “what stakeholder processes have proved to be particularly effective.”³⁴ One of the initiatives in the CAISO five-year plan for enhancing customer service (see § B.2, above) is “Stakeholder Process Improvement”: “Develop and implement a process for considering and making customer identified changes to business practice manuals, improve meeting notice and document availability, and develop new mechanisms to enhance the stakeholder process.” To illustrate the extent of the process, in 2007 alone the CAISO has held 40 stakeholder meetings, 88 stakeholder conference calls, and 15 CPUC workshops. Stakeholders have told officers and board members that these processes are working.

4. “Transparent RTO and ISO Budget Processes” (¶¶162-163)

The ANOPR relates stakeholder concerns about “[in]adequate opportunity to review or understand an RTO’s or ISO’s budget in time to

³³ ANOPR ¶160.

³⁴ ANOPR ¶161.

influence the budget decision,” particularly with ISOs that use a formula rate. See ANOPR ¶162. The Commission proposes several measures to improve the transparency of budget processes at ISOs, and enhance the opportunities for stakeholder influence. All of the key measures³⁵ were implemented by the CAISO as part of its rate case settlement in 2004. On the basis of its positive experience with them, the CAISO recommends adoption of the Commission’s proposals.

In 2004, the CAISO and its stakeholders established an extensive stakeholder process for budget planning and stakeholder feedback, which is now incorporated in the CAISO Tariff.³⁶ The process begins with public discussion with stakeholders before the CAISO begins internal budget meetings. Stakeholders are asked to provide input on budget priorities for the coming year and have an opportunity to discuss these issues with executive management. Stakeholder comments and suggestions are posted on the website and provided to all staff involved in the internal budget process. The CAISO also provides extensive data related to the budget of each department and provides stakeholders with a single point of contact for all budget-related questions. In addition, stakeholders are provided with a multi-year budget forecast and a detailed analysis of bill determinants to

³⁵ The only exception is that the CAISO does not “[s]ubmit to the Commission as an informational filing the budget materials provided to stakeholders for review,” as suggested in ANOPR ¶ 163. The CAISO would have to objection to such a requirement.

³⁶ CAISO Tariff Appendix F, Part D; *see also* ANOPR ¶ 144.

reduce the uncertainty concerning the potential for future rate changes. Stakeholders are encouraged to comment on the budget at all stages and have every opportunity to raise concerns at any level of the ISO, including the ISO Board of Governors.

Stakeholder input has not been unduly burdensome and, at the same time, has been helpful in reducing costs and improving transparency. Given this experience, the CAISO endorses the Commission's proposals.

C. "Proposed Commission Actions to Improve Demand Response and Market Pricing During a Power Shortage" (¶¶ 57-82)

1. Treating Demand Response like Other Resources (¶¶ 59-61)

The CAISO supports the Commission's proposal to "obligate each RTO or ISO to purchase demand response resources in its markets for certain ancillary services, similar to any other resources," subject to meeting certain requirements.³⁷ The success of this proposal will depend primarily on the WECC.³⁸ The CAISO must satisfy WECC's requirements for minimum contingency reserves – requirements that cannot be altered by the CAISO. Currently, demand response is eligible to provide only one type of contingency reserve product: non-spinning reserves. WECC is considering a set of changes to its standards for spinning reserves that would permit

³⁷ ANOPR ¶ 59.

³⁸ *Cf.* ANOPR ¶ 61.

demand response to provide that service as well.³⁹ The CAISO supports these changes to the extent they do not adversely affect grid reliability. But in order for the CAISO to procure spinning reserve or any other ancillary service (besides non-spin) through demand response in the near future, the Commission would have to issue a separate directive to the ERO (*i.e.*, NERC) to effect a change in WECC standards.

Regarding a minimum bid size for demand response products,⁴⁰ the CAISO notes that 1 MW is the smallest quantity currently handled by the CAISO markets.⁴¹ The additional administrative burden of handling smaller bids would likely outweigh any benefit to market efficiency or grid reliability.

2. Aggregators of Retail Customers (§§ 68-74)

The CAISO tariff already permits aggregation of load under the Participating Load Program.⁴² As such, the CAISO has no objection to the Commission's proposed requirement that ISOs permit demand response by

³⁹ Background information and discussion of the WECC's efforts to develop a Frequency Responsive Reserve product, which is intended to replace the Spinning Reserves component of Operative Reserves, can be found in the document, WECC- Reserves Issues Task Force, White Paper Frequency Response Standard Reserve Issues Task Force, dated November 24, 2005. This document can be found on the WECC's Internet web site at http://www.wecc.biz/documents/library/RITF/FRR_White_Paper_v12_1-27-06.pdf.

⁴⁰ See ANOPR § 61.

⁴¹ See, *e.g.*, CAISO Tariff §§ 4.6.3.1 (exempting generators with maximum capacity of less than 1 MW from compliance); 36.2.3 (Firm Transmission Rights to be issued in denominations of 1 MW); 40.2.2 (effectively exempting loads with forecast peak less than 1 MW from submitting resource adequacy plans).

⁴² Additional information about this program can be found on the web site at <http://www.aiso.com/docs/2005/10/05/2005100520280423155.html>.

aggregated retail customers, subject to satisfying applicable state law.⁴³ The CAISO intends to revisit the technical standards for aggregated loads in the Participating Load Program in order to ensure they do not unnecessarily discourage participation. In addition, the CAISO has committed to working together with other members of the RTO-ISO Council to identify best practices and common approaches, beginning with telemetry and measurements.⁴⁴

The CAISO takes no position on the appropriate level of compensation for demand response aggregators.

3. Scarcity Pricing (§§ 75-82)

The CAISO agrees that, during emergency conditions of supply shortages, market rules that limit price may have the unintended effect of making demand response less attractive, and that scarcity pricing can be a valuable mechanism for facilitating demand response.⁴⁵ Currently, the CAISO is working with its stakeholders to evaluate various approaches to scarcity pricing, pursuant to the Commission's directive to implement it within 12 months after the start of MRTU.⁴⁶ The initial design will use a

⁴³ See ANOPR §§ 69-72.

⁴⁴ Cf. *id.* § 71.

⁴⁵ See ANOPR §§ 75-76.

⁴⁶ See Order Conditionally Accepting the California Independent System Operator's Electric Tariff Filing to Reflect MRTU, 116 FERC ¶ 61,274 (2006), §§ 1076-79.

demand curve approach, as directed by the Commission,⁴⁷ but the CAISO will also consider other approaches for later implementation. Because this stakeholder process is at an early stage, it would be premature for the CAISO to take a position that any one of the four approaches outlined in the ANOPR is preferable. However, we do provide general observations about three of the approaches – the first, third and fourth – and urge that the Commission not mandate a single approach for all ISOs and RTOs.

i. Approach One – Increasing Energy Bid Caps And Price Caps Above The Current Levels Only During An Emergency (¶ 76)

In connection with the first proposed approach to scarcity pricing, the Commission has asked “what operating conditions should constitute an emergency shortage”?⁴⁸ The CAISO believes that should depend on dropping below a reserve threshold – for example, five percent.

With that said, the CAISO has two concerns about increasing bid or price caps during emergencies. First, the CAISO’s market monitor believes that an increase would undermine the purpose of the caps, which is to allow prices to arise – within reason – during scarcity conditions. As such, bid caps are more reflective of demand’s willingness to pay than the marginal cost of supplying energy. In other words, the potential shortage condition should already be factored in when the cap is set.

⁴⁷ *See id.*

⁴⁸ ANOPR ¶ 77.

Moreover, if the caps are raised only in the real-time market, it may create an incentive for suppliers to not offer into the day-ahead market and wait until the real-time market to offer their generation. A day-ahead must-offer requirement would mitigate this concern. But in the absence of convergence bidding, which would allow supply that clears the day-ahead market to be effectively settled at the real-time price, suppliers would be forced to sell in the day-ahead market at a potentially lower price. This applies to all scarcity pricing triggered in this fashion. Until the CAISO implements convergence bidding, this presents an obvious problem. In the meantime, the Commission should ensure that any rule requiring the CAISO to implement this approach subjects the day-ahead market to the same pricing rules as the real-time market.

Finally, there is a timing issue with this approach that would make it unworkable. Market bids are submitted in advance of actual system conditions. At the time an emergency is declared by the CAISO, bids for the operating hour will have been already submitted. While suppliers might be able to submit bids above the cap in the subsequent hour, the emergency may be over by then, which raises the issue of how to treat such bids (*i.e.*, should the market software reject them or truncate them to the original bid cap). There will likely be other implementation complexities with this approach that make it inferior to other options.

ii. Approach Three – Establish a Demand Curve for Operating Reserves (§ 79)

The CAISO also urges the Commission to provide flexibility in whether or how a demand curve for operating reserves is applied to shortages with respect to local reliability requirements. Local requirements may be designed to reflect the reliability and cost preferences of entities within any control area. Since such preferences may vary by control area, flexibility in how scarcity pricing is applied to these is warranted.

iii. Approach Four – Set the Market Clearing Price for Generators and Demand at the Payment Made to Participants Under an Existing Emergency Demand Response Program (§ 80)

The fourth proposed approach is not presently workable in California. Although the State of California has approximately 1600 MW available for load reduction during emergencies, this demand response is at the retail level, which is under the jurisdiction of the CPUC. Thus, much of the demand response remains under the retail programs, even though MRTU allows Participating Loads to set nodal prices. In principle, pricing measures could be established that allow the retail demand response programs to set wholesale prices, and the CAISO would support such efforts. For example, the price could be set based on the cost of the various demand response programs that are triggered. Alternatively, the cost of these programs could be incorporated into the level of any demand curve (the third approach). Of course, any such approach would require cooperation from and coordination

with state authorities – presumably the Public Utilities Commission.

iv. Should the Commission Require One Specific Method of Scarcity Pricing? (§81)

The CAISO urges the Commission to adopt only a general requirement for scarcity pricing, allowing each RTO and ISO to develop its own compliance mechanism by choosing one or more of the options outlined by the Commission. It would be a mistake to mandate one specific method, because the efficiency of the various alternatives depends too heavily on the details of the particular market design. Even relatively minor changes to a single market could significantly change the effects of an approach. Some flexibility is therefore necessary.

D. Long-Term Power Contracting in Organized Markets (§§ 83-94)

The CAISO is willing to post any information that the Commission believes would enhance prospects for long-term contracting. Otherwise, the CAISO has no comment on the proposals in this section.

III. CONCLUSION

The CAISO requests that the Commission consider these comments.

Respectfully submitted,

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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, CA, on this 14th day of September, 2007.

/s/Susan Montana
Susan Montana