



October 29, 2002

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation **Docket Nos. ER02-1656-001**
ER02-1656-002
ER02-1656-003
ER02-1656-004
ER02-1656-005
ER02-1656-006

Investigation of Wholesale Rates of Public Utility Sellers Of Energy and Ancillary Services In the Western Electricity Coordinating Council **Docket No. EL01-68-019**

Dear Secretary Salas:

The California Independent System Operator Corporation (“ISO”)¹ respectfully submits six copies of this filing in compliance with the Commission’s October 11, 2002 “Order On Rehearing And Compliance Filing,” 100 FERC ¶ 61,061(2002) (“October 11 Order”), and the Commission’s October 24, 2002 “Notice of Extension of Time” extending the date for submitting the instant compliance filing, issued in the above-referenced dockets.

I. BACKGROUND

The instant compliance filing is in response to portions of the October 11 Order concerning rehearing requests of the Commission’s July 17, 2002 “Order On The California Comprehensive Market Redesign Proposal,” 100 FERC ¶ 61,060 (2002) (“July 17 Order”). Additionally, the instant compliance filing also addresses the October 11 Order directives concerning parts of the ISO’s compliance filings of August 16 and 21, 2002, filed in response to the July 17 Order.

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

II. PROPOSED CHANGES TO SECTIONS OF THE ISO TARIFF AND PROTOCOLS

As described below, the ISO proposes changes to the ISO Tariff to comply with the October 11 Order. Descriptions of the proposed Tariff modifications are contained in the following sections, whose headings reflect the relevant headings in the October 11 Order.

The instant filing includes proposed Tariff modifications for the following elements of the ISO's comprehensive market design for 2002 ("MD02"): Automatic Mitigation Procedures ("AMP"), Price Cap, Single Energy Bid Curve, Real Time Economic Dispatch ("RTED"), and the Uninstructed Deviation Penalty ("UDP"). The AMP, Price Cap and Single Energy Bid Curve are elements of MD02 Phase 1 scheduled for implementation on October 30, 2002. Both RTED and UDP, also elements of MD02 Phase 1, are scheduled for implementation by mid-2003. As a result of the Commission's required stakeholder process, the ISO anticipates a further filing, under Section 205 of the Federal Power Act, of additional Tariff modifications for certain elements of MD02 Phase 1.

As described below in Section III, the instant filing includes a conformed Tariff containing the Tariff language that the Commission has approved to date as well as proposed language contained in pending compliance filings (including the present filing). However, the instant filing does not include a comprehensive set of black-lined and clean Tariff sheets for all MD02 proposed Tariff changes as have been proposed by the ISO and/or modified by the Commission in MD02 filings and Commission order beginning with the ISO's initial MD02 filing on May 1, 2002 in the above-referenced dockets ("May 1 Compliance Filing") and proposed to take effect after October 30, 2002. The Commission has noted that it will address the issue of changes to the Tariff proposed to take effect after October 31, 2002 at a later date² and so the ISO will await the Commission order on these later changes before submitting additional Tariff changes.

A. Changes Intended to Be Effective October 30, 2002

The following changes are proposed to be effective October 30, 2002. The ISO refers to the MD02 elements to take effect on this date as the "Phase 1-A elements."

1. Automatic Mitigation Procedures

In the October 11 Order, the Commission reversed its prior decision set forth in the July 17 Order that AMP should be applied to imports (which the ISO understands to mean System Resources as defined in the ISO Tariff (*i.e.*,

² "Notice of Extension of Time," Docket No. ER02-1656-001, *et al.* (Oct. 24, 2002).

generating resources located outside of the ISO Control Area) not under a Participating Generator Agreement. The Commission directed that AMP not be applied to imports and further required that all bids from “outside California” into ISO Real Time Markets must be set at \$0/MWh. October 11 Order at ¶ 20. The ISO is unsure whether the phrases “imports” and “outside California” mean “outside the ISO Control Area” or “outside the State of California”. Given that the Commission’s directive to require bidders “outside California” to bid at \$0/MWh is issued in the context of concerns about megawatt laundering, and since megawatt laundering can occur within California but outside the ISO Control Area, and consistent with prior ISO compliance filing to the Commission’s price mitigation provisions, the ISO will continue to interpret the phrase “outside California” to mean “outside the ISO Control Area”. The ISO proposes a new Section 2.5.23.3.8 to implement this directive. Additionally, the ISO proposes to modify Sections 2.5.23.1 and 2.5.23.2.1 to exclude System Resources from setting the Market Clearing Price (“MCP”), thus ensuring such resources are “price takers”.

The Commission also clarified that if the MCP is projected to be above \$91.87/MWh in any zone within the ISO Control Area, AMP should be conducted for bids throughout all zones in the ISO Control Area. October 11 Order at ¶ 30. The ISO proposes to modify Market Monitoring and Information Protocol Appendix A Section 4.2.2(e) to implement this directive.

The Commission affirmed that the criteria for calculation of reference price levels as filed by the ISO in the May 1 Compliance Filing also should be followed by the independent entity that the Commission required the ISO to retain for such calculations. October 11 Order at ¶ 33. Further clarifying how reference price levels are to be calculated, in the October 11 Order at ¶ 35, the Commission expressly stated that the term “accepted bids” does not include proxy or mitigated bids and that the data requirement for use of accepted bids over the previous 90 calendar days is satisfied if at least one bid has been accepted in that period. The ISO proposes to modify Market Monitoring and Information Protocol Appendix A Section 3.1.1.1 accordingly.

Addressing non-gas-fired generating units, the Commission clarified that hydro-electric generating resources within the ISO Control Area voluntarily bidding into ISO markets are subject to AMP and eligible to set the MCP. October 11 Order at ¶ 40. The ISO proposes a new Section 2.5.23.3.8.1 to implement these requirements. Moreover, under the adopted criteria for calculation of reference prices, the ISO affirms the Commission directive that the independent entity should consider negotiated rates using opportunity cost data supplied by non-gas-fired generating units, if accepted bids are not available. *Id.*

Lastly, the Commission directed that a price screen is not required when the ISO must accept bids out of economic merit order in the BEEP stack to

address Intra-Zonal Congestion. October 11 Order at ¶ 41. The ISO proposes changes to Market Monitoring and Information Protocol Appendix A Section 3.1.1 to comply with this directive. The Commission also directed the ISO to post mitigated out-of-sequence bids on OASIS within 24 hours. October 11 Order at ¶ 22. The ISO is preparing software changes that will publish the confidential mitigated bids to the Scheduling Infrastructure (“SI”) workspace for specific Scheduling Coordinators within 24-hours of any such mitigation. Moreover, the ISO will publish on OASIS a notice if any such bid mitigation has occurred.

The ISO has modified Market Monitoring and Information Protocol Appendix A Section 4.2.2(b) to make clear that the Mitigation Measures only will be applied to incremental bids and not to decremental bids. While the Commission did not specifically order this clarification, the ISO proposes this modification to eliminate any doubt in this regard.

2. Price Cap

The Commission directed that suppliers may submit bids above the west-wide price cap of \$250/MWh into the ISO markets. The Commission also directed that bids above \$250/MWh may not set the MCP and are subject to justification and refund. October 11 Order at ¶ 17. The ISO proposes to modify Section 28.1.2 to implement this directive.

Potomac Economics, Ltd. (“Potomac”), the independent entity calculating reference prices, has determined: (1) that the Mitigation Measures should be applied to bids above \$250/MWh, even though such bids cannot set the Market Clearing Price, and (2) that accepted and justified bids above \$250/MWh should be included in the calculation of reference prices. The ISO proposes to modify Market Monitoring and Information Protocol Appendix A Section 3.1.1.1 to implement this directive. A letter from Potomac to the ISO setting forth Potomac’s position on this issue is included as Attachment E to the instant filing.

The Commission declined to take any action in regards to the ISO’s assertion that the negative \$30/MWh floor on negative decremental bids does not provide adequate protection against the exercise of local market power, but noted that the ISO was free to file a Tariff amendment under Section 205 of the Federal Power Act to propose a change in that floor. October 11 Order at ¶ 45. The ISO is considering filing such a Tariff amendment.

3. Single Energy Bid Curve

The Commission directed that suppliers may increase or decrease bids in the ISO Real Time Market for capacity associated with that part of the bid curve that was not accepted in the Hour-Ahead Market. Moreover, the Commission directed that, for committed capacity, a supplier may not submit higher bids but

may submit lower bids in the Real Time Market. October 11 Order at ¶ 54. The ISO proposes to modify Section 5.13.1 in compliance with the Commission's directive.

4. Bidding Requirements

The Commission directed that "bidders outside California" must continue to submit \$0/MWh bids into ISO markets. October 11 Order at ¶ 20. Additionally, the Commission noted that hydro-electric resources within the ISO Control Area are eligible to set the MCP. As set forth in the Commission's December 19, 2001 Order concerning the California markets, under the price mitigation that expires on October 30, 2002, hydro-electric resources were not required to bid \$0/MWh but were not permitted to set the MCP.³ The ISO proposes new Sections 2.5.23.2.8 and 2.5.23.3.8.1 to set forth these requirements.

B. Changes Related to Real Time Economic Dispatch and Uninstructed Deviation Penalties

The items in this section address: (1) implementing changes to clear the Price Overlap and establish a continuous energy bid stack (the "Real-Time Economic Dispatch" changes) and (2) implementation of Uninstructed Deviation Penalties ("UDP"). The ISO refers to these MD02 changes as Phase 1-B items. Due in part to the time needed to develop software to implement these Phase 1-B elements, the ISO estimates that the elements will be implemented in 2003, and proposes that the elements become effective upon written notice by the ISO to the Commission and Market Participants.

The Commission directed that no UDP would apply to Schedule changes after the Day-Ahead Market and before the Real Time Market. October 11 order at ¶ 57. The ISO proposes a new Section 11.2.4.1.2(r) to comply with the Commission's directive.

The Commission directed that Schedule changes made after the close of the Hour-Ahead Market in accordance with the terms of Existing Transmission Contracts would be exempt from UDP. October 11 Order at ¶ 59. While the existing Section 11.2.4.1.2(q) was intended to accomplish what the Commission directed, the ISO has modified that section to clarify that section's intent.

The Commission directed that UPD cannot be assessed if the ISO issues a Dispatch Instruction that does not conform to the ISO's Dispatch Protocol.

³ See "Order On Clarification and Rehearing," 97 FERC ¶ 61,275, at 62,192-93 (2001) ("December 19 Order").

October 11 Order at ¶ 62. The ISO proposes new Section 11.2.4.1.2(s) to comply with the Commission's directive.

The Commission directed the ISO to file proposed Tariff language that would exempt a generator from UDP if the deviations occurred because of environmental constraints or because the generator was complying with an operating permit or applicable law. October 11 Order at ¶ 65. The ISO agrees that generators must comply with all relevant environmental restrictions, resource operating permits and all other applicable laws. The ISO also agrees with the intent of the Commission requirement. It is impossible, however, for the ISO to know each environmental rule, permit condition or applicable law for each of the several hundred generating units that may bid and be Dispatched by the ISO at any given time. Moreover, it is the legal obligation of the generating unit to comply with such rules and regulations. Therefore, it must be incumbent on each generator to bid its unit in such a way that both: (1) meets the requirements of the Must Offer Obligation, and (2) respects environmental constraints, complies with its specific operating permit and conforms to all applicable law.

Stated otherwise, when the ISO receives a bid from a generator to provide Real Time Imbalance Energy, the ISO must assume that it can Dispatch that bid without condition. To assume otherwise would transfer to the ISO an obligation to determine if accepting such a bid would or would not violate an environmental constraint, operating permit or law particular to that generating unit. The ISO simply does not have the time to undertake this responsibility in Real Time for the hundreds of units that may be Dispatched. Moreover, the ISO is neither a party to such underlying environmental restrictions and operating permits nor the responsible party that must comply with applicable laws governing the resource itself. The ISO does not know the restrictions and so cannot reasonably be expected to undertake the risk of incurring whatever sanction is in place for a violation of such laws and regulations. This risk and responsibility rests with the generator. The ISO therefore proposes Tariff language that requires the generator to submit bids that are lawful and in compliance with all legal and regulatory constraints upon the generating unit. By requiring lawful bids, the ISO may then perform its function, namely the timely Dispatch of bids in such a way as to ensure reliability of the transmission grid. The ISO proposes new Section 2.2.6.12 to impose upon Scheduling Coordinators the obligation to submit bids that, upon the ISO acceptance and Dispatch, will comply with all relevant environmental constraints, operating permits and applicable law.

The Commission directed the ISO to restore the sentence "Uninstructed energy resulting from declining intra-hour Instructions will not be subject to an Uninstructed Deviation Penalty." to Section 11.2.4.1.2(c). October 11 Order at ¶ 66. This sentence was first filed in Section 11.2.4.1.2(b) in the May 1, 2002

MD02 filing, and applied only to Interconnection Schedules.⁴ In the MD02 Tariff language filed by the ISO on June 17, 2002, a new subsection 11.2.4.1.2 (b) was proposed. The sentence that the Commission directed the ISO to restore was moved to 11.2.4.1.2(c) and deleted from that section. The Tariff language filed on June 17, 2002, however, was to take effect on the later of May 1, 2003, or when the ISO announced it was ready to implement the MD02 long-term elements. On September 20, 2002, the ISO filed Tariff language that inadvertently omitted the sentence in 11.2.4.1.2(b) the Commission has now directed the ISO to restore.⁵ While the Commission directed the ISO to restore this deleted sentence in Section 11.2.4.1.2(c), the sentence should be restored to Section 11.2.4.1.2(b), which, again, applies only to Interconnection Schedules. Restoring that sentence without narrowly applying it only to Interconnection Schedules would exempt all intra-hour Dispatch Instructions from UDP. That would effectively render UDP meaningless, since the majority of Dispatch Instructions to which UDP would apply are intra-hour instructions issued from the ISO's Balancing Energy Ex Post Pricing ("BEEP") stack to provide real time Imbalance Energy. The ISO has modified Section 11.2.4.1.2(b) accordingly.

The Commission accepted the ISO's request for rehearing to allow the ISO to implement Real-Time Economic Dispatch (i.e., the system to clear the Price Overlap to yield a continuous bid stack) and the UPD simultaneously. The ISO currently expects to implement these items in 2003.

C. Changes Related to the Expiration of Price Mitigation

The Commission approved Section 11.2.4.2.2 as part of Amendment No. 42⁶ to exempt Scheduling Coordinators from having costs incurred above the Non-Emergency Clearing Price Limit ("NECPL") allocated to them if they had sufficient incremental Energy bids in the Imbalance Energy Market to cover their net negative uninstructed deviations (and therefore were not withholding Energy from the ISO). The NECPL was the limit on the MCP in non-emergency periods and will not be in effect after the price mitigation established in the April 26 and

⁴ That Section read: "The Uninstructed Deviation Penalty will apply to Interconnection Schedules if a pre-dispatch instruction is declined or not delivered. However, uninstructed energy resulting from declining Intra-hour instructions will not be subject to Uninstructed Deviation Penalty Dynamic Interconnection Schedules, to the extent they deviate without instruction from their Final Hour-Ahead Schedules, and real-time instructions for Energy from Interconnection Schedule bids that are declined, will be subject to the Uninstructed Deviation Penalty." The ISO proposed to exempt Interconnection Schedules because such Schedules are pre-determined before the hour and are not changed within an hour except in an emergency. Declining an intra-hour instruction for an Interconnection Schedule would therefore be consistent with Western Energy Coordinating Council practice and should not result in the application of UDP.

⁵ See September 20, 2002 ISO filing in Docket Nos. ER02-651-002, *et al.* ("September 20, 2002 Filing").

⁶ "Order Accepting in Part and Rejecting in Part Tariff Amendment No. 42 and Dismissing Complaint," 98 FERC ¶ 61,327 (2002).

June 19, 2001 Orders concerning the California markets⁷ expires on October 30, 2002. The ISO therefore proposes to modify Section 11.2.4.2.2 to replace the NECPL with the maximum MCP of \$250/MWh that will be in effect beginning October 30, 2002. The ISO requests that this modification be effective October 30, 2002.

D. Changes Proposed on September 20, 2002

In the September 20, 2002 Filing, the ISO filed proposed changes for when price mitigation expires, now set for October 30, 2002. These changes included:

- 1) Moving the deadline for submitting Supplemental Energy bids from forty-five minutes before the hour to sixty minutes before the hour. These changes are to Section 2.5.22.4.1, Section 5.13.2.1, and Dispatch Protocol Section 7.3.
- 2) Extending the provisions of Amendment No. 43, which expired on October 1, 2002, to pay System Resources the instructed price in all BEEP Intervals. These changes are to Section 11.2.4.1.
- 3) Limiting the liability of Potomac Economics, Ltd., the independent entity calculating reference prices. These changes are in a new Section 14.4.
- 4) Clarifying that reference prices shall be updated daily. These changes are to Market Monitoring and Information Protocol Appendix A Section 3.1.1.1.

By order on October 25, 2002, in the above-referenced dockets, the Commission approved these four changes, to be effective on October 30, 2002. While logistics prevent the ISO from filing these approved modifications as conformed Tariff sheets, for clarity and completeness, the ISO now re-files these provisions as black-lined (*i.e.*, proposed and pending) modifications. The ISO will file clean Tariff sheets reflecting these approved provisions at the earliest possible time.

⁷ "Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale Western Energy Markets," 95 FERC ¶ 61,115 (2001); "Order On Rehearing of Monitoring and Mitigation Plan for the California Wholesale Electric Markets, Establishing West-Wide Mitigation, and Establishing Settlement Conference," 95 FERC ¶ 61,418 (2001).

E. Other Changes

The ISO proposes to correct typographical errors in Sections 5.13.1 and 5.13.2.1 in which references to Dispatch Protocol Section 8.6.4(j) should be to Section 8.6.3(j). There is no Dispatch Protocol Section 8.6.4.

III. CONFORMED ISO TARIFF

In the October 11 Order, the Commission required the ISO to provide:

(1) proposed Tariff revisions with corrected effective dates; (2) a clean set of all the proposed Tariff revisions that the ISO has made since May 1, 2002 in Docket No. ER02-1656, including the proposed Tariff revisions it is directed to file as discussed in the body of the October 11 Order; and (3) a redline version of all of the proposed Tariff revisions that the ISO has made since May 1, 2002 in Docket No. ER02-1656, including the proposed Tariff revisions it is directed to file as discussed in the body of the October 11 Order. The Commission also required that the redline version clearly show the differences that the ISO is proposing to its Tariff as compared to the currently effective Tariff. Finally, the redline version must be organized by subject matter.

October 11 Order at ¶ 88. To satisfy the Commission's directives, the ISO now submits the entire conformed, in-effect ISO Tariff and the attachments described below.

The conformed ISO Tariff, provided in Attachment I to the instant filing, includes all proposed changes contained in pending compliance filings, including the present filing. In order to clearly indicate which language in the conformed ISO Tariff reflects pending compliance filings, the ISO has shaded the text of pending compliance filing language; further, the ISO provides a table in Attachment G to the instant filing that specifies the filing date and docket number of each of the pending compliance filings, the sections that these filings concern, and the subject of each of the sections.

Additionally, the conformed ISO Tariff contains updated effective dates on the Tariff pages related to implementation of MD02 elements and expiration of west-wide price mitigation, which the ISO provides primarily in response to direction contained in a number of Commission Orders.⁸ The ISO has provided in Attachment F to the instant filing a table indicating which sections of the ISO

⁸ As shown in Attachment F, the Commission has issued directives in a number of Orders related to implementation of MD02 elements and expiration of west-wide price mitigation. See April 26 Order, June 19 Order, December 19 Order, and July 11 Order.

Tariff have the updated effective dates, the elements of MD02 and/or expiration of west-wide price mitigation to which the sections relate, and the statuses of the sections.

The ISO notes that the conformed Tariff also contains various ministerial changes relating to combination of Tariff sections accepted in different proceedings but not previously included together on the same Tariff sheet, and removal of rejected material inadvertently omitted from effective Tariff sheets. These ministerial changes are contained on conformed Tariff sheets 103A, 184G, 184H, 184I, 247D, 256A, 322, 333A, 355, and 563A.

In addition to meeting the Commission's directives in the October 11 Order, the ISO believes that its provision of the conformed ISO Tariff will serve as a convenience for the Commission and parties, will assist in understanding what the currently effective ISO Tariff entails, and will permit the Commission and parties to place the ISO's compliance with the Commission's directives in the October 11 Order within the context of the entire conformed Tariff.

IV. ATTACHMENTS TO THE INSTANT FILING

In addition to this transmittal letter, the instant filing contains the following attachments:

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| Attachment A | Revised Tariff sheets to reflect the changes to the Tariff and Protocols sections described in Sections II.A, II.C, and II.D, above, each with an effective date of October 30, 2002. |
| Attachment B | Sheets showing, in black-line format, the Tariff and Protocol changes described in Sections II.A, II.C, and II.D, above. |
| Attachment C | Revised Tariff sheets to reflect the changes to the Tariff and Protocols sections described in Sections II.B and II.E above, each to be effective upon notice provided by the ISO to the Commission and Market Participants. |
| Attachment D | Sheets showing, in black-line format, the Tariff and Protocol changes described in Sections II.B and II.E, above. |
| Attachment E | Letter from Potomac Economics, Ltd. to the ISO described in Section II.A.2, above. |
| Attachment F | Table of Tariff changes related to implementation of MD02 elements and expiration of west-wide price mitigation described in Section III, above. |

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- Attachment G Table of pending proposed changes to sections of the Tariff and Protocols described in Section III, above.
- Attachment H A form notice of filing suitable for publication in the Federal Register, as well as a computer diskette containing the notice of filing in WordPerfect format.
- Attachment I The conformed ISO Tariff described in Section III, above.

In addition, two extra copies of the filing are enclosed. Please date-stamp the extra copies with the time and date of filing and return them to the messenger. Thank you for your assistance in this matter.

Respectfully submitted,

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Dated: October 29, 2002