

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System)
Operator Corporation) Docket No. ER98-3594-
000

**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION TO MOTIONS TO INTERVENE
AND RESPONSE TO COMMENTS AND PROTESTS**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (1998), the California Independent System Operator Corporation ("ISO") submits this answer to the motions to intervene and response to comments and protests submitted in this docket.¹ As stated herein, the ISO does not oppose any of the interventions. The ISO also provides its

¹ Many of the substantive issues addressed in this Answer were raised in pleadings styled as "Motions," "Comments," or "Comments and Protest." The prohibition in Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), does not apply to these issues. To the extent this Answer responds to protests, the Commission has also accepted answers to protests, notwithstanding Rule 213(a)(2), that assist the Commission's understanding and resolution of the issues raised in a protest, *Long Island Lighting Co.*, 82 FERC ¶ 61,129 (1998), clarify matters under consideration, *Arizona Public Service Co.*, 82 FERC ¶ 61,132 (1998); *Tennessee Gas Pipeline Co.*, 82 FERC ¶ 61,045 (1998), or materially aid the Commission's disposition of a matter, *El Paso Natural Gas Co.*, 82 FERC ¶ 61,052 (1998). The ISO's Answer will clarify matters under consideration, aid the Commission's understanding and resolution of the issues and help the Commission to achieve a more accurate and complete record, on which all parties are afforded the opportunity to respond to one another's concerns. *Northern Border Pipeline Co.*, 81 FERC ¶ 61,402 (1997); *Hopkinton LNG Corp.*, 81 FERC ¶ 61,291 (1997). The Commission should accordingly accept this Answer.

responses to the issues raised in the comments and protests of certain of the parties.

BACKGROUND

On December 4, 1998, the ISO submitted an amendment to its June 30, 1998, filing in this docket. The June 30, 1998, filing tendered Amendment No. 9 to the ISO Tariff, which would govern the issuance and use of Firm Transmission Rights (“FTRs”).² The December 4, 1998, amendment (the “Supplemental Filing”) incorporates an expanded Section 9.4, providing a detailed description of the auction process for FTRs. The Supplemental Filing also incorporates a number of changes in response to comments received on the initial filing. The ISO explained that the auction process and other changes were discussed extensively with stakeholders before submittal of the Supplemental Filing.

The Commission noticed the ISO’s Supplemental Filing on December 9, 1998, with interventions and protests due on or before December 28, 1998. Numerous parties submitted Motions to Intervene, Comments or Protests.³ Both the Public Utilities Commission of the State of California and the Electricity

² Capitalized terms used herein and not defined are used with the meanings given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

³ The California Public Utilities Commission (“CPUC”), Bonneville Power Administration (“Bonneville”), California Department of Water Resources (“DWR”), California Electricity Oversight Board, Cities of Redding, et al. (“Redding”), City and County of San Francisco (“San Francisco”), Duke Energy Trading & Marketing, LLC, Electric Clearinghouse, Inc., Energy Producers & Users Coalition (“EPUC”), Enron Power Marketing, Inc. (“Enron”), Los Angeles Department of Water & Power (“LADWP”), Metropolitan Water District of Southern California (“MWD”), Modesto Irrigation District (“MID”), New York Mercantile Exchange (“Mercantile Exchange”); Northern California Power Agency (“NCPA”); Pacific Gas & Electric Co. (PG&E), PSEG Resources,

Oversight Board, as well as certain other intervenors, support the revisions to Amendment No. 9 as filed.

DISCUSSION

The ISO does not oppose the intervention of any of the parties that have moved to intervene in this proceeding. The Comments and Protests raised questions or concerns about Amendment No. 9 that fall into two categories: some questions and concerns go to issues raised by the auction process described in proposed Section 9.4; others to issues concerning the nature, implementation, and effect of FTRs. Each category of issues is discussed below. In a number of instances, an intervenor's comments ask the Commission to overturn the resolution of competing concerns that was reached through the stakeholder process culminating with the decision of the ISO Board of Governors to approve the Supplemental Filing. Where the stakeholder process has resulted in a reasonable balance of the relevant considerations, as the ISO will show was done here, the Commission should resist entreaties to upset that outcome.

The ISO also notes that some intervenors use their comments on the Supplemental Filing to restate objections to the basic approach to firm transmission rights reflected in Amendment No. 9. Some of these objections address specific portions of Amendment No. 9, and are discussed in section II, *infra*. Other comments concern the basic nature of FTRs. Certain intervenors,

Inc. (PSEG"), Sacramento Municipal Utility District ("SMUD"), San Diego Gas & Electric Company ("SDG&E"), Southern California Edison Company ("Edison"), Transmission Agency of Northern California ("TANC"), and The Utility Reform Network and Utility Consumer Action Network ("TURN/UCAN"). A number of these parties had previously intervened in this docket.

for example, oppose FTR Holders' having any physical scheduling priority.⁴ Other intervenors argue that unless the physical scheduling priority for FTR Holders is extended to the Hour-Ahead Market or conformed to point-to-point service under a pro forma-based tariff, the ISO Tariff will not provide "firm transmission service."⁵ One party reiterates its belief that FTRs should be awarded directly to Converted Rightholders, in addition those issued through the auction.⁶ The ISO has addressed these issues in its initial Answer in these proceedings and will not repeat that discussion here. It is sufficient to note that FTRs, as implemented through Amendment No. 9, are not a stand-alone approach to transmission access. Each transmission customer taking service under the ISO Tariff is assured of service with the same priority as other customers using the Converted Rights that have been turned over to the ISO's control. FTRs supplement those rights by enabling a customer that has already secured transmission access to hedge the risks of fluctuating transmission congestion charges and of non-economic curtailments in the Day-Ahead Market. It is therefore inappropriate to compare FTRs alone to point-to-point transmission service. FTRs are but one facet of transmission service under the ISO Tariff. As the ISO has shown in its initial transmittal of Amendment No. 9 and in its August

⁴ TURN/UCAN Protest at 11-13, 15. TURN/UCAN indicate that they are willing to acquiesce in the physical rights aspect of Amendment No. 9 if other modifications are made. Those issues will be discussed below.

⁵ DWR Comments at 2; Redding Protest at 13-16.

⁶ DWR Comments at 9.

4, 1998, Answer to Motions to Intervene, Comments and Protests, transmission under the ISO Tariff, including Amendment No. 9, is equal or superior to transmission service under a pro forma-based tariff.

I. THE PROPOSED FTR AUCTION DESIGN

As explained in the ISO's Supplemental Filing, FTRs would be issued through a separate multi-round auction for each FTR Market. In each market, the price at which FTRs would be made available will be increased in each round, and bidders will have the opportunity to indicate the number of FTRs they are willing to purchase at the indicated price, until the demand for FTRs matches the supply. The proposed Section 9.4 provides a detailed description of the auction process. That process was discussed at length with stakeholders, and modified in response to those discussions, before the Supplemental Filing was submitted.

The interventions raise relatively few issues with the proposed auction design. No modification to the proposed auction design is necessary as a result of any of the comments.

1. The proposed auction design appropriately determines an opening price for FTRs. Under the proposed auction design, an opening or "seed" price at which FTRs will initially be made available in each market must be announced. That price will then be increased in subsequent rounds, if necessary, until the demand for FTRs matches the supply. Section 9.4.2.1(ii) accordingly sets out a formula for determining the opening prices for each FTR

Market in the auction. The prices are based on the Congestion experienced on the relevant interface (in the relevant direction) during the past year. The level of Congestion is as reflected in the net Usage Charges on the relevant interface. On interfaces where there has been little historical Congestion, the ISO has established a floor of \$100/MW-year.

This formula was the product of the stakeholders' discussion on how the auction should commence. Some participants believed that no seed price should be established, but rather that FTRs should initially be offered at zero.⁷ Other participants argued for a starting price sufficiently high to protect the interests of the customers of Participating Transmission Owners ("TOs"), who receive the proceeds of the FTR auctions. The formula balances those concerns by specifying a relatively low seed price, in order to leave room for supply and demand to converge.

Two objections were raised to the formula -- one claiming that it could produce results that are too high in some circumstances, the other complaining about circumstances in which the result could be too low. Enron argues that the formula's use the ratio of Usage Charges to total MW-years of Energy scheduled on the path could lead to an overstatement of the opening price for a lightly scheduled interface.⁸ While Enron's example supports its concern, the concern

⁷ Enron and NCPA, in stating that "the market" should determine the initial price, continue to advocate this position. Enron Protest at 7; NCPA Motion at 10.

⁸ Enron Protest at 7.

is in actuality only theoretical. Paths with low capacity factors will generally be subject to the \$100 minimum bid. Only those paths with high capacity factors will be subject to an initial price determined by the formula.

TANC argues that the portion of the Energy scheduled on an interface that is transmitted pursuant to Existing Contracts should be excluded from consideration in setting the initial FTR price.⁹ The ISO agrees. The term “MW-Years scheduled over the Inter-Zonal Interface,” as used in the formula, is intended to include only new firm uses and not energy scheduled under Existing Contracts.

2. The auction design appropriately gives the ISO the discretion to adjust the rate at which prices increase between rounds of the auction and other implementation details. Before the auction commences, the ISO will post on its Home Page a formula through which prices will be adjusted in rounds of the auction following the first round. Under proposed Section 9.4.2.3, the ISO is authorized to adjust the coefficients of the posted formula (within a range that will be posted at the outset), with notice to all FTR bidders. In this way, if small price increases are not leading to the convergence of demand and supply in an FTR Market, the ISO can expedite the process of the auction.

Edison notes that excessively large price increases between rounds could create a risk that the auction would close prematurely, resulting in an artificially

⁹ TANC Protest at 8.

low market-clearing price.¹⁰ It urges that, if an auction closes immediately after the ISO changes the price increment, the auction will be re-run using a smaller price increment. The ISO does not believe the amendment proposed by Edison is necessary. The ISO recognizes the risk that large price increases could eliminate the room required for demand and supply to converge. To minimize this risk, the ISO will exercise restraint in adjusting price increments during the FTR auction. The ISO believes that the minimal risk of premature auction closure does not warrant the added complications and uncertainty that would be associated with providing for the mandatory re-running of FTR auctions. The ISO also notes that revising the software currently under development to accommodate the mandatory re-running of FTR auctions would lead to a delay in the initial issuance of FTRs, as well as additional cost.

Redding argues that the formula for inter-round price adjustments, as well as the schedule for each round of the auction, and the specifications for equipment needed to participate in the computerized auction, should be filed as part of the ISO Tariff.¹¹ The ISO does not believe that this level of detail is appropriately filed. As noted, the ISO will post the formula, the schedule, and the equipment specifications, on its Home Page at least 30 days in advance of the auction. The ISO should have the flexibility to modify these details for future

¹⁰ Edison Protest at 3-4.

¹¹ Redding Protest at 25.

FTR auctions, based on experience, without the necessity of presenting a tariff amendment for the Commission's review and approval.

Similarly, Redding's suggestion that information provided to auction participants during the course of the auction be posted on the ISO's Home Page¹² is unworkable. A dedicated computer-based system will be used to disseminate this information and to receive bids. Posting this intermediate information on the ISO Home Page could complicate and delay the conduct of the auction. The ISO believes that only the results of the auctions are appropriately posted on the ISO Home Page.¹³

3. The Tariff formula for allocating FTRs does not call for allocating a negative value. Because the auction in each FTR Market closes when the demand for FTRs is less than or equal to the number of FTRs being made available, Section 9.4.2.5 sets out a formula for allocating the difference between the total demand for FTRs in the final round of the auction and the total being made available. LADWP expresses concern that one component of the formula could be interpreted as providing for the allocation of a negative number, because the number of FTRs demanded in the final round of the auction will

¹² Redding Protest at 26. Redding's Protest refers to Sections 9.4.2.2 and 9.4.7.3. The ISO assumes the second reference should be to Section 9.4.2.3.

¹³ As explained below, the ISO agrees with a suggestion made by certain intervenors to provide for the publication of price information resulting from FTR auctions, as determined by the ISO Board of Governors.

always be less than the total quantity of FTRs being made available.¹⁴ The ISO confirms that this variable will not be interpreted to reduce the FTRs allocated to a successful bidder. The whole purpose of the formula is to allocate the available FTRs that were not demanded in the final round of the auction; if that number is not positive, the formula is not applied. The ISO accordingly does not believe any change in the tariff provision is necessary.

4. The FTR auction design incorporates an appropriate provision to enable a bidder to decline a small award of FTRs. During the course of the stakeholder discussions, a concern was expressed that, if the auction process resulted in the award of a small amount of FTRs to a bidder, the bidder might believe that the value of those FTRs did not justify the cost of managing them. Section 9.4.2.5 accordingly provides that a bidder may decline an award of FTRs that is less than five percent of its initial bid in the FTR Market.

No intervenor opposes this feature of the auction design. DWR argues, however, that the threshold should be based on a fixed monetary value.¹⁵ The ISO disagrees. A fixed monetary value would be less responsive to the needs of bidders for FTRs. Within any FTR Market, some bidders would place a higher value than others on FTRs and therefore would be more willing than others to bear the associated management burdens. The ISO therefore believes that it is

¹⁴ LADWP Comments at 4.

¹⁵ DWR Comments at 5.

reasonable to relate the point at which a bidder may decline an award of FTRs to the bidder's initial expression of interest in FTRs in that FTR Market. That is what the proposed auction design does.

5. The prohibition of bids for additional FTRs in subsequent rounds appropriately discourages auction participants from withholding bids. Proposed Section 9.4.2.3 bars a bidder from increasing the number of FTRs it requests in subsequent rounds of the auction, when prices increase. This provision is designed to ensure that the auction proceeds efficiently by requiring bidders to submit bids for all the FTRs they desire at a given price. If an FTR bidder could increase its bid in a subsequent round, when the price is higher, it could withhold bids in early rounds. TANC questions the application of this principle in an FTR Market in which the initial demand is less than the supply of FTRs.¹⁶ The same principle applies in this circumstance. Bidders should submit initially a bid that reflects their true demand for FTRs in a market. There is no valid reason for a bidder's demand to increase simply because the FTRs are undersubscribed.

II. OTHER ISSUES

1. The FTR design strikes a reasonable balance between the demands of a free market and the need to protect against the exercise of

¹⁶ TANC Protest at 13.

excess market power. A number of comments focus on a perceived need for additional measures to preclude the exercise of market power through the FTR process. EPUC seeks a limit on the number of FTRs issued, or alternatively a limit on the portion of the FTR's that an individual purchaser could hold.¹⁷

TURN/UCAN assert that if scheduling rights are to be included in FTRs, greater transparency is necessary in the secondary market. In particular, TURN/UCAN seeks reporting of prices at which FTRs trade in the secondary market.¹⁸

LADWP agrees that secondary market purchases should be registered, and aggregated price indices published.¹⁹ TANC calls for the implementation of a "more rigorous" market monitoring program, with a reassessment of the FTR design prior to the ISO's implementation of a new Access Charge methodology.²⁰

In contrast, Redding believes that limiting FTRs to 25% of available capacity may hinder the development of a vibrant market.²¹ Enron opposes any registration of secondary market FTRs as an unwarranted intrusion into the market place.²²

¹⁷ EPUC Protest at 5-6.

¹⁸ TURN/UCAN Protest at 9, 15.

¹⁹ LADWP Comments at 2.

²⁰ TANC Protest at 11.

²¹ Redding Protest at 22. While the Mercantile Exchange supports the filing, it, too, would have preferred the initial release of more FTRs.

²² Enron Protest at 10-11.

As the ISO noted when it first submitted Amendment No. 9, it shares the concerns that market participants might use FTRs to exercise market power or that the trading of FTRs in secondary markets might limit the ability of the ISO's Market Surveillance Unit to detect the exercise of that power. As detailed in the ISO's August 4, 1998, Motion for Leave to File Answer and Answer to Motions to Intervene, Comments and Protests at 16-19, the FTR proposal contains numerous provisions developed through the stakeholder process and designed to protect against the exercise of market power without hindering the development of a robust market. The ISO, including in particular its Market Surveillance Unit, is fully committed to careful study and monitoring of the impact of FTRs on the ISO's ability to operate the grid reliably and efficiently, on the robustness of the Adjustment Bid market, and on the ability of market participants to exercise market power. If the ISO's monitoring reveals market problems, the ISO will promptly take action to remedy those problems, and will propose revisions to Amendment No. 9 as necessary. In the absence of evidence that protections included in Amendment No. 9 are insufficient to protect against market abuse, the ISO believes it inappropriate to upset the balance so painstakingly crafted through the stakeholder process.

The ISO does, however, believe that the provision of certain additional information to the market participants could have positive effects. MWD and TANC suggest the addition of a provision authorizing the ISO to publish on the ISO Home Page such information concerning the price of FTRs as its Board of

Governors determines to be appropriate.²³ The ISO considers the addition of this general authority beneficial as a means of addressing market power concerns that may arise.

2. Amendment No. 9 strikes a reasonable balance among considerations that promise the certainty of the value of FTRs and those ensuring fair treatment of all transmission customers. In developing the attributes of FTRs, as reflected in Amendment No. 9, the ISO and the stakeholders had to address a number of questions concerning the nature of FTRs. The resolution of these issues affects the value of FTRs to potential bidders, and therefore the proceeds that Participating TOs and their customers will receive from FTR auctions. Decisions that tend to increase the value of FTRs could, however, raise concerns that transmission customers that have not obtained FTRs may be treated unfairly. The stakeholder process devoted substantial time to balancing these considerations in deciding upon the attributes of FTRs. The proposal embodied in Amendment No. 9 is certainly not the only possible scheme for the implementation of FTRs, but rather reflects a reasonable balance among competing considerations, a balance that received the approval of the stakeholders in the California market.

Nonetheless, certain parties offer comments that would significantly alter that balance. One of the attributes of FTRs that maintain their value is the

²³ MWD Protest at 9; TANC Protest at 10.

priority afforded to FTR Holders in the allocation of Usage Charge revenues in periods of Inter-Zonal Congestion and line capacity reductions.²⁴ Various intervenors oppose this priority for FTR holders.²⁵ The value of FTRs is also maintained through the certainty provided by proposed Section 9.2.2.1, which specifies that changes in the definition of Zones would not take effect until the expiration of the term of existing FTRs that would be affected, i.e., until the end of the calendar year. Redding opposes this provision.²⁶

Other parties suggest changes that would enhance the value of FTRs beyond that proposed by Amendment No. 9. As noted above, FTR Holders are given a physical scheduling priority only in the Day-Ahead Market. Some intervenors repeat their requests to extend this priority to the Hour-Ahead Market.²⁷ In addition, under Section 9.6.4, FTR Holders may be subject to charges if an interface is derated following the closing of the Day-Ahead Market, on the same basis that Participating TOs are subject to charges in these

²⁴ See proposed Sections 9.6.3 and 9.7.2.1.

²⁵ Edison Protest at 4; SDG&E Protest at 8; LADWP Comments at 3;

²⁶ Redding Protest at 21. TANC asserts that proposed Sections 9.2.2.1 and 9.2.2.2 are repetitive. The two provisions address related, but distinct subjects. Section 9.2.2.1 addresses the timing of changes in the definition of Zones. Section 9.2.2.2 provides that if a change in the definition of an Inter-Zonal Interface (which can only take effect in accordance with Section 9.2.2.1) results in the auction of additional FTRs, the new FTRs will not diminish the rights associated with existing FTRs.

²⁷ See n. 5, supra.

circumstances.²⁸ A number of comments recommend relieving FTR Holders from this responsibility.²⁹

The ISO believes that the attributes of FTRs, as reflected in Amendment No. 9, represent a reasonable resolution of various alternative approaches. The Commission has recognized that one of the important functions of an ISO is to provide a forum for stakeholders to debate and resolve policy questions in a fair and nondiscriminatory manner.³⁰ While it is certainly possible to conceive of a system of FTRs that has different attributes, the current proposal represents a compromise reached through the stakeholder process. Consistent with the importance that the Commission has placed on the California stakeholder process, *see, e.g., AES Redondo Beach*, 85 FERC at 61,463; *California Independent System Operator Corporation*, 84 FERC ¶ 61,217 (1998), and in light of the reasonableness of the result, the Commission should not overturn the outcome reflected in Amendment No. 9.

²⁸ See Section 9.7.3 of the ISO Tariff. The financial exposure of Participating TOs and FTR holders under such circumstances would be modified, and ameliorated, by the ISO's pending Amendment No. 13.

²⁹ DWR Comments at 3; NCPA Motion at 8; Enron Comments at 9; Redding Comments at 19-20.

³⁰ *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540, 21,596 (May 10, 1996), FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,036 (1996), *clarified*, 76 FERC ¶ 61,009 and 76 FERC ¶ 61,347 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), III FERC Stats. & Regs. ¶ 30,048 (1996), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *appeals pending*.

3. Amendment No. 9 appropriately recognizes counter-scheduling. The ISO Tariff currently provides (in Section 7.3.1.5) that Scheduling Coordinators whose transactions create additional capacity on a Congested Inter-Zonal Interface will receive Usage Charges to reflect the fact that their transactions reduce Congestion. Amendment No. 9 does not change this provision. It simply recognizes in Section 9.2.1 that FTR Holders, like Participating TOs, are entitled to share only in the net Usage Charge revenues received by the ISO, i.e., the Usage Charge revenues remaining after Usage Charges are paid for counter-scheduling. Some intervenors object to this provision, but their complaints lack substance.³¹ The rationale for paying Usage Charges for counter-scheduling is clear: doing so compensates Scheduling Coordinators whose transactions increase capacity on congested interfaces, thereby encouraging a practice that helps the ISO manage Congestion. Usage Charge revenues paid to counter-scheduling transactions obviously are not available to distribute to FTR Holders.

4. Amendment No. 9 applies to all Converted Rights. Some intervenors contend that clarification or further amendments to the ISO Tariff will be necessary to address the creation of FTRs in connection with the conversion of rights under Existing Contracts for transmission service to Converted Rights,

³¹ DWR Comments at 4; TANC Protest at 12, 13.

over which the ISO grants access pursuant to the terms of the ISO Tariff.³² The ISO in no way forecloses the development of additional mechanisms to handle the conversion of rights under Existing Contracts; indeed, the ISO Tariff contemplates in Section 2.4.4.3.1.4, that such alternative mechanisms might be developed. As DWR acknowledges, the ISO has indicated its willingness to consider proposals on that subject from DWR. Regardless of whether any such proposals are presented, the ISO Tariff, including Amendment No. 9, already provides a mechanism for the conversion of rights under Existing Contracts.

Under Section 2.4.4.3 of the ISO Tariff, a recipient of firm transmission service under an Existing Contract can convert its rights to ISO transmission service and thereby become a Participating TO. As a Participating TO, the entity is entitled to a share of the net Usage Charges received by the ISO under Section 7.3.1.6 of the ISO Tariff.³³ In addition, the new Participating TO is entitled to a share of the proceeds of the ISO's auction of FTRs under proposed Section 9.5.1. There is no distinction in that provision between Participating TOs whose Converted Rights are based on ownership of transmission facilities and those whose Converted Rights are based on contract rights; all share in FTR

³² DWR Comments at 6-13; NCPA Motion at 4.

³³ If the entity's rights under an Existing Contract are to less than firm service, its rights to share in Usage Charges, and therefore in FTR auction proceeds, will be reduced accordingly under Section 2.4.4.3.1.4.

auction proceeds.³⁴ The new Participating TO will also be entitled to develop an Access Charge to recover its Transmission Revenue Requirement, subject to any applicable regulatory review, which will be payable by Market Participants withdrawing Energy from the portion of the ISO Controlled Grid made up by its Converted Rights.³⁵ Proposed Section 9.5.1 provides that all Participating TOs – both current and new – will credit their shares of the proceeds of FTR auctions against their Access Charges.³⁶

As noted above, the ISO Tariff acknowledges that alternative arrangements can be made for entities wishing to convert their rights under Existing Contracts to ISO transmission service. The ISO is willing to discuss proposals for alternative arrangements and, should any proposal be approved, to file appropriate amendments to the ISO Tariff. Even if such arrangements are not developed, however, the ISO Tariff already provides a mechanism to accommodate the conversion of rights under Existing Contracts and to treat the

³⁴ For this reason, there is no need to clarify, as NCPA suggests (Motion at 7), that converted contract rights are also included. The terms used in Section 9.5.1 automatically include them.

³⁵ DWR's belief that a new Participating TO that owns no transmission facilities will have neither a Transmission Revenue Requirement nor an Access Charge is incorrect. At a minimum, such a Participating TO could include its payments under the existing transmission contracts that it converts to ISO transmission service in its Transmission Revenue Requirement. It can then establish an Access Charge to recover a portion of those payments from any customers who withdraw energy from the portion of the ISO Controlled Grid represented by its converted contract rights.

³⁶ As explained in note 34, above, all Participating TOs can establish an Access Charge. DWR's proposed changes to Sections 7.3.1.6 and 9.5.1 are accordingly unnecessary. They are also inappropriate because they would not require all Participating TOs to credit the proceeds they receive from FTR auctions against their transmission revenue requirements, for the benefit of customers.

new Participating TOs on a basis comparable to the treatment of current Participating TOs.

5. Amendment No. 9 appropriately defines the transmission capacity for which FTRs are available. Proposed Section 9.3.1 calls for the ISO to issue FTRs for a portion (to be decided by the ISO Governing Board and set initially at 25%) of the available transmission capacity on each Inter-Zonal Interface and direction combination. The available transmission capacity is defined as the difference between the rating of the path, determined by the Western Systems Coordinating Council (“WSCC”) or in accordance with its procedures, and the portion of the path's transfer capability committed to the scheduling of transmission under Existing Contracts.

Several intervenors take issue with different aspects of this formula. TANC contends that the use of an WSCC rating or methodology is inappropriate.³⁷ Although TANC complains about aspects of the WSCC rating methodology, it does not detail its concerns. In any event, the use of the established interface rating as the outer limit on the number of FTRs that will be issued is plainly reasonable.

Redding questions who will apply the WSCC methodology to an interface that has not received a rating.³⁸ The answer is that the ISO will do so, taking into

³⁷ TANC Protest at 13.

³⁸ Redding Protest at 24.

account information provided by Market Participants, including the owners of the facilities and rights making up the interface.

Other intervenors argue that only transmission rights that have a higher priority than service under the ISO Tariff should be deducted from a path's rated capacity.³⁹ As filed on June 30, 1998, Section 9.3.1(ii) followed this approach. The provision was modified based on stakeholder input during the discussions that preceded the Supplemental Filing to take into account all capacity available for scheduling under Existing Contracts. The ISO believes that this approach, which reduces somewhat the number of FTRs that will initially be issued on some interfaces, is appropriate. The question of the priority of so-called "conditional firm" rights under certain Existing Contracts is highly controversial among the parties to the Existing Contracts. Limiting the capacity deducted for Existing Contract rights could be considered to involve the ISO in interpreting the rights of parties under those contracts, which would be contrary to the limitation set out in Section 2.4.4.4.1.1 of the ISO Tariff. The specification of the capacity available for FTRs in the initial auction is not the appropriate place to attempt to resolve the treatment of conditional firm rights, especially when FTRs are to be issued initially for only a portion of the available transfer capacity.

³⁹ See DWR Comments at 14; Enron Protest at 8-9. Redding argues that this provision may require modification in a different respect if its position in a pending rehearing request is upheld. Redding Protest at 23. The ISO suggests that this issue is premature. It can be taken up when Redding's rehearing issue is resolved, if it is resolved in Redding's favor.

The approach set forth in Section 9.3.1 has been applied to all interfaces over which FTRs will be issued, including "Path 15," a transmission path on the system of Pacific Gas and Electric Company. Contrary to the implications of some intervenors, that path receives no special treatment.⁴⁰ If there is any transfer capability available that is not devoted to pre-existing transactions, that capacity will be included in determining the number of FTRs to be issued for the Inter-Zonal Interface of which Path 15 is a part.

Finally, one intervenor asks that, in addition to posting on the ISO Home Page the number of FTRs to be issued for each Inter-Zonal Interface and direction, in accordance with proposed Section 9.4.2.1(i), the ISO post an explanation of the derivation of those numbers. The ISO does not believe that the posting of information should be required. As explained above, the formula for the calculation of the total available transmission capacity available for FTRs is straightforward, and the ISO Board of Governors will publicly determine the portion of that capacity that will be available as FTRs. No purpose would be served by posting the calculation showing the application of this formula.

6. There is no need for the Commission to mandate review of FTR auction procedures. ECI proposes that Section 9 be modified to require the review of FTR auction procedures by the ISO and Scheduling Coordinators

⁴⁰ See ECI Protest and Comments at 3.

within 45 days following the initial auction.⁴¹ This suggestion is unnecessary, and, as proposed, inappropriate. As the ISO explained in filing Amendment No. 9, it intends to monitor closely all aspects of FTRs. That includes the auction procedures, as well as the impact of the issuance of FTRs on its markets, including on the availability of Adjustment Bids to enable the ISO to manage Congestion efficiently. A specific provision for such review is unnecessary. Nor would the ISO's review be limited to Scheduling Coordinators, as ECI proposes. Instead, all stakeholders will be able to participate, to review the results of the ISO's analysis, and to suggest any needed improvements.

7. Amendment No. 9 appropriately requires Participating TOs to credit FTR auction proceeds in the same manner that Usage Charge revenues are credited. Section 9.5.1 provides that each Participating TO that receives a share of the FTR auction proceeds shall credit those proceeds against its Access Charge. In this way, the transmission customers paying the Access Charge, who bear the costs of the Participating TO's transmission facilities and/or contract rights, receive the benefit of the FTR auction.

NCPA asserts it is inappropriate to "pre-judge. . . the access fee outcome."⁴² The ISO disagrees. Section 7.3.1.6 of the ISO Tariff already requires Participating TOs to credit Usage Charge revenues they receive against

⁴¹ ECI Comments and Protest at 4.

⁴² NCPA Motion at 11.

their Access Charges. The proceeds of the auction of FTRs will replace in part the Usage Charge revenues received by Participating TOs. FTR auction proceeds and Usage Charge revenues should accordingly be treated in the same way. They should both be disbursed to Participating TOs and credited by them against their Access Charges.

For the same reason, it would be inappropriate, as some intervenors suggest, to specify that the proceeds of FTR auctions should be credited to the Access Charges paid by only some customers of Participating TOs – i.e., those within the Zone to which Energy deliveries are constrained by Congestion.⁴³ That suggestion would treat FTR auction proceeds differently than Usage Charge revenues, causing some customers of Participating TOs to benefit at the expense of others. In any case, questions regarding whether a particular Participating TO should credit FTR auction proceeds against its Access Charge in a uniform manner or in some other way are appropriately resolved in proceedings on that TO's Transmission Owner Tariff, not in this proceeding.⁴⁴

8. The scheduling priority of FTR Holders is clear. Section 9.7.3 provides that, if the transfer capability of an interface, adjusted for the portion used to schedule firm rights under Existing Contracts, "is less than the total of all

⁴³ San Francisco Comments at 3.; NCPA Motion at 11.

⁴⁴ Redding's notation (Protest at 26) that Participating TOs' Access Charges may require modification to reflect a credit for the proceeds of FTR auctions and TANC's question (Protest at 14) concerning the allocation of the ISO's costs in implementing the FTR proposal similarly raise issues that are beyond the scope of this proceeding.

scheduling capability represented by FTR holders who have chosen to exercise the FTR scheduling priority option, scheduling capability shall be allocated to FTR Holders pro rata." LADWP questions whether this allocation will be based on proposed schedules or on FTRs held by the scheduling party.⁴⁵ The ISO believes the quoted provision is clear. That provision applies only if there is insufficient capacity to schedule the transactions of FTR Holders who are exercising their scheduling rights in the Day-Ahead Market. In that circumstance, the available capacity will be allocated among those FTR Holders, based on the schedules they submit using the FTR scheduling priority.

9. The financial security requirements for FTR Holders are appropriate. Proposed Section 9.2.6 requires all FTR Bidders to meet the financial requirements applicable to Scheduling Coordinators (although it does not require them to become Scheduling Coordinators) and bars an FTR Bidder from submitting bids that exceed the value of its financial security. These requirements provide assurance that a bidder can pay for the FTRs it seeks to acquire. Some intervenors argue that the financial security requirements should not apply after an entity has paid for the FTRs for which it successfully bid.⁴⁶ In fact, nothing in Section 9.2.6 requires an FTR bidder to maintain financial

⁴⁵ LADWP Comments and Protest at 5.

⁴⁶ MWD Protest at 10; TANC Protest at 11; NCPA Motion at 10.

security in effect once the auction has concluded and it has made any required payments. No change is required.

10. Amendment No. 9 does not modify the treatment of Existing Contracts in Congestion Management. TANC expresses concern that proposed Section 9.7.2.1 does not adequately protect schedules using Existing Contracts in the event of Congestion. This concern is unfounded. The new provision specifies that, when Inter-Zonal Congestion cannot be managed through Adjustment Bids, schedules of firm rights under Existing Contracts will have first call on available transmission capacity. This is consistent with current practice, including Section 8.5 of the ISO's Dispatch Protocol, which specifies that, in this circumstance, the ISO will implement the Operating Instructions provided to it with respect to Existing Contracts.

CONCLUSION

For the reasons stated herein, the ISO respectfully requests that the Commission accept, without modification, Amendment No. 9 as revised by the December 4, 1998, proposal.

Respectfully submitted,

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Dated: January 12, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, D.C. this 12th day of January, 1999.

Sean A. Atkins