

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

**California Independent System            )       Docket No. ER10-188-000  
Operator Corporation                    )**

**COMMENTS OF THE CALIFORNIA INDEPENDENT  
SYSTEM OPERATOR CORPORATION IN SUPPORT OF THE  
OFFER OF SETTLEMENT**

Pursuant to Rule 602(f) of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.602(f) (2009), the California Independent System Operator Corporation (“ISO”) hereby submits its comments on the Offer of Settlement (“Settlement”) that it filed on behalf of various parties on March 23, 2010, concerning the ISO’s market usage-forward energy charge. The ISO requests that the Commission approve the Settlement as filed.

**I. BACKGROUND**

The background information on the Settlement is set forth in the Explanatory Statement. For the reader’s convenience, the ISO reproduces that background statement here.

On February 20, 2008, the ISO filed a tariff amendment revising its grid management charge rate design to accommodate the ISO’s market operations under its Market Redesign and Technology Update. The Commission accepted the ISO’s proposed amendment, with the exception of two modifications that parties had protested.<sup>1</sup> The Commission directed the ISO to submit a compliance filing to include previously accepted language regarding load-

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<sup>1</sup> *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,338. (2008).

following metered sub-systems that the ISO had proposed to delete from its tariff<sup>2</sup> and to propose tariff language addressing the treatment of inter-scheduling coordinator trades in calculating market usage-forward energy charges.<sup>3</sup> The market usage-forward energy charge is designed to recover the portion of the ISO's costs of administering its markets that is associated with forward energy purchases and sales.

On January 21, 2009, the ISO submitted its compliance filing. The ISO proposed to clarify that the market usage-forward energy charge would apply to energy in the day-ahead market as offset by physical (but not financial) inter-scheduling coordinator trades. In response to a protest filed by the Northern California Power Agency ("NCPA"), the ISO filed an answer in which it agreed that both types of trades should be included in the market usage-forward energy charge allocation formula. The ISO offered to file tariff revisions with this clarification. Finally, the ISO stated that it would conduct a future stakeholder process to re-evaluate the market usage-forward energy charge, including recovery of the administrative costs associated with inter-scheduling coordinator trades.<sup>4</sup>

In a March 2009 Order, the Commission accepted the ISO's grid management charge compliance filing, subject to a further compliance filing by the ISO consistent with the positions in the ISO's answer.<sup>5</sup> The Commission

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<sup>2</sup> *Id.* at P 40.

<sup>3</sup> *Id.* at P 46.

<sup>4</sup> *Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,021 at P 4, *reh'g denied*, 129 FERC ¶ 61,293 (2009), citing ISO Answer, Docket No. ER08-585-001, filed February 26, 2009 at 3.

<sup>5</sup> *Cal. Indep. Sys. Operator Corp.*, 126 FERC ¶ 61,289, at P 7 (2009).

accepted the ISO's subsequent compliance filing on July 14, 2009.<sup>6</sup>

Consistent with its commitment, the ISO initiated a stakeholder process regarding the market usage-forward energy charge on August 3, 2009, and held a stakeholder meeting on August 18, 2009. The ISO posted a straw proposal on August 28, 2009, and held a second stakeholder meeting on September 15, 2009. After a subsequent stakeholder conference call on September 30, 2009, the ISO posted its final proposal on October 2, 2009. The ISO conducted a final stakeholder conference call on October 21, 2009.

On October 30, 2009, the ISO filed proposed tariff revisions to extend the existing grid management charge until December 31, 2010, with one exception: the CAISO proposed to revise the market usage-forward energy charge (1) to exclude inter-scheduling coordinator trades from the calculation;<sup>7</sup> (2) to base the charge on day-ahead energy schedules rather than purchases and sales; and (3) to calculate the charge based on the greater of a scheduling coordinator's total supply schedules or total demand schedules, rather than the difference between purchases and sales (the "modified gross" approach).

In support of its filing, the ISO noted that, although allocating the market usage-forward energy charge to "gross" energy schedules, rather than "net" energy schedules, is most consistent with cost causation, replacing the current netting approach with a gross approach could have excessive rate impacts on some scheduling coordinators. To mitigate these impacts, the ISO proposed the modified gross approach as an interim measure until the ISO's completion of a

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<sup>6</sup> *Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,021.

<sup>7</sup> The ISO explained that the purpose of this tariff change was solely to clarify the existing tariff language.

new cost-of-service study for the grid management charge.

No parties protested the ISO's proposed amendment. Some, however, stated concerns about the proposed allocation of the market usage-forward energy charge and expressed a preference for a different allocation, and others challenged the ISO's statements regarding cost causation. On December 30, 2009, the Commission accepted the ISO's amendment with one exception. The Commission found that the ISO had failed to justify the modified gross approach as just and reasonable. The Commission suspended the market usage-forward energy charge for five months and set it for hearing.<sup>8</sup>

On January 20, 2010, Administrative Law Judge Judith A. Dowd convened a settlement conference. During the conference, the ISO presented additional information on the cost impact of the various potential allocations of the market usage-forward energy charge and answered questions. Various parties expressed their positions on the ISO's proposal. Judge Dowd adjourned the settlement conference until March 3, 2010, so that the parties could exchange information and continue informal discussions.

On February 23, 2010, the ISO circulated a settlement proposal, which it revised on February 25, 2010. On March 3, 2010, the parties met telephonically for further discussions. Based on those discussions, the ISO made additional changes to the proposal. The ISO circulated a revised proposal on March 5, 2010. Subsequently, the other settling parties joined the ISO in making the pending settlement offer.

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<sup>8</sup> *Cal. Indep. Sys. Operator Corp.*, 129 FERC ¶ 61,292, at P 22 (2009) ("December 30 Order").

## II. STANDARD FOR APPROVAL

The Commission may approve an uncontested settlement if it is fair and reasonable and in the public interest.<sup>9</sup> For contested settlements, the Commission may decide those settlement issues that have been contested on the merits if there is substantial evidence in the record or if there are no genuine issues of material fact respecting those issues.<sup>10</sup> The Commission may also sever contesting parties or issues and treat the settlement as uncontested.<sup>11</sup> If the record lacks substantial evidence or severance is not possible, the Commission may set the matter for hearing or take such other action that it determines to be appropriate.<sup>12</sup>

Under these regulations, the Commission has identified four approaches for approving a settlement: (1) the Commission may make a decision on the merits of each contested issue; (2) the Commission determines that the settlement provides an overall just and reasonable result; (3) the Commission determines that the benefits of the settlement outweigh the nature of the objections, and the contesting parties' interests are too attenuated; or (4) the Commission determines that the contesting parties can be severed.<sup>13</sup>

The ISO does not know as yet if any party will contest issues regarding the Settlement. If there are contested issues, the ISO will address them in its reply comments. The ISO submits, however, that even if a party raised

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<sup>9</sup> 18 C.F.R. § 385.602(g)(3).

<sup>10</sup> 18 C.F.R. § 385.602(h)(1)(i).

<sup>11</sup> 18 C.F.R. § 385.602(h)(1)(iii).

<sup>12</sup> 18 C.F.R. § 385.602(h)(1)(ii)(B).

<sup>13</sup> *San Diego Gas & Elec. Co. v. Sellers of Ancillary Serv.*, 130 FERC ¶ 61,197 at n.4 (2010), citing *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 at 62,342-44 (1998).

contested issues, the Commission should approve the Settlement because it provides an overall just and reasonable approach.

### **III. COMMENTS SUPPORTING OFFER OF SETTLEMENT**

As discussed in the declarations of Mr. Michael K. Epstein and Dr. Lorenzo Kristov<sup>14</sup>, the methodology for allocating the market usage-forward energy costs in the Settlement is the same methodology filed by the ISO on October 30, 2009.

In the December 30 Order, the Commission set for hearing the issue of whether the proposed methodology was just and reasonable. The Commission did *not* find that the proposal was unjust, unreasonable, or unduly discriminatory. Rather, the Commission concluded that the ISO had not made a sufficient showing that the methodology was just and reasonable.

Subsequently, after settlement discussions, the settling parties concluded that the proposal as filed provided an appropriate allocation of the costs associated with the market usage-forward energy services pending a cost-of-service study to be conducted for the ISO's 2012 grid management charge. The ISO submits that if the Settlement is uncontested, the Commission should approve it as fair and reasonable and in the public interest. Further, the ISO submits that, if the Settlement is contested, the Commission should find it just and reasonable based on the additional information provided in the Declarations of Mr. Epstein and Dr. Kristov.

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<sup>14</sup> See Declarations of Mr. Michael K. Epstein ("Attachment 1") and Dr. Lorenzo Kristov ("Attachment 2") on Behalf of the California Independent System Operator Corporation.

The functionalization of the ISO's costs and their allocation to cost categories and subcategories was detailed in the ISO's February 20, 2008, filing.<sup>15</sup> The Commission approved this allocation when it found the grid management charge just and reasonable.<sup>16</sup> The Settlement does not propose to change this aspect of the market services-forward energy charge, and there has been no complaint filed to suggest that the cost-of-service support is no longer applicable.

One aspect of the billing determinants for the market usage-forward energy charge is also unchanged by the Settlement. Inter-scheduling coordinator trades were offset in the calculation of the billing determinant in the ISO's compliance filing as approved by the Commission.<sup>17</sup> The billing determinant under the Settlement similarly does not include inter-scheduling coordinator trades and there have been no complaints filed to suggest that intervening events have rendered this exclusion unjust and unreasonable.

The only question before the Commission is thus whether revising the billing determinants from the net energy to the greater of the energy included in supply bids or demand bids is just and reasonable. In this regard, it is important to note that there can be more than one just and reasonable rate.<sup>18</sup> A utility

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<sup>15</sup> See "Revisions to Grid Management Charge" submitted by the ISO under ER08-585-000 (February 20, 2008).

<sup>16</sup> *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,338 (2008). The functionalization and categories are described in the Testimony and Exhibits of Mr. Ben Arikawa, submitted in the February 20, 2008 filing, found at: [http://elibrary.ferc.gov/idmws/Doc\\_Family.asp?document\\_id=13583234](http://elibrary.ferc.gov/idmws/Doc_Family.asp?document_id=13583234).

<sup>17</sup> *Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,021, *reh'g denied*, 129 FERC ¶ 61,293 (2009)

<sup>18</sup> See, *Cities of Bethany v. FERC*, 727 F.2d 1131, 1138 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 917 (1984); *Ala. Elec. Coop., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982); *Int'l Transmission Co.*, 123 FERC ¶ 61,065, at P 20 (2008).

proposing a rate is not required to demonstrate that its proposal is more reasonable than alternative proposals, but only to show that its proposal yields rates that are just and reasonable.<sup>19</sup> The same principles apply to an offer of settlement. Under the Commission's rules, discussed above, the Commission need only find that the settlement is just and reasonable as a package. It does *not* require that the offer of settlement provide the most just and reasonable rate.

Significantly, in accepting the existing allocation, the Commission did not demand a detailed evaluation of alternatives for measuring forward energy market activity. By stating that it was appropriate that the grid management charge reflect cost causation<sup>20</sup> and accepting the existing allocation as just and reasonable, the Commission implicitly accepted that the netting methodology generally reflected scheduling coordinator's use of the forward energy markets.

Here, Dr. Kristov has explicitly set forth the reasons that a gross methodology is more just and reasonable than the previously accepted netting methodology. He explains that processing supply bids imposes the same costs on the ISO as processing demand bids.<sup>21</sup> Netting supply and demand fails to reflect that reality. As Dr. Kristov states, "Under netting, the ISO would charge a scheduling coordinator that cleared ten megawatt-hours of supply in the market based on ten megawatt-hours, but would charge nothing to the scheduling coordinator that cleared five megawatt-hours of supply and five megawatt-hours

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<sup>19</sup> See *Transcontinental Gas Pipe Line Corp.*, 87 FERC ¶ 61,087, at 61,387-88 (1999); "*Complex*" *Consol. Edison Co. of New York v. FERC*, 165 F.3d 992, 1003-04 (D.C. Cir. 1999); *Tennessee Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,224 (1997).

<sup>20</sup> *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,338 at P 25 (2008).

<sup>21</sup> See Attachment 2, Declaration of Dr. Lorenzo Kristov on Behalf of the California Independent System Operator Corporation.

of demand, even though both scheduling coordinators received equivalent services.”<sup>22</sup> Based on these circumstances, the ISO believes that under the current functionalization and categorization of costs, allocating the costs to scheduling coordinators according to the sum of supply bids and demand bids – the “gross” methodology – would best align the charges with cost causation. If all other things were equal, the ISO would support the use of the gross methodology.

There is, however, a countervailing consideration. As documented by Mr. Epstein, the gross methodology would have a very significant cost impact on load-serving entities. Understandably, load-serving entities have expressed strong opposition to the gross methodology, and the ISO is sympathetic to the need to avoid sudden cost increases, particularly during a period of difficult economic times for many ratepayers. This is particularly so when the ISO is planning to conduct a cost-of-service study in 2010 and 2011, for use in the 2012 grid management charge development, that might yield a revised functionalization and categorization of costs associated with the forward markets.

The Settlement therefore adopts a compromise that was proposed during the stakeholder process by Powerex: allocation of the charge based on the greater of a scheduling coordinator’s total supply schedules or total demand schedules – the “modified gross” methodology. As evidenced by the comments filed in response to the October 30, 2009, filing, this methodology was acceptable to the vast majority of parties.

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<sup>22</sup> *Id.* at P 14.

Although this methodology may not be the methodology most consistent with cost causation, that fact does not render it unjust, unreasonable, or unduly discriminatory. As the Commission has stated:

[C]ost causation principles require that “all approved rates reflect *to some degree* the costs actually caused by the customer who must pay them.” Compliance with this principle is evaluated “by comparing that costs assessed against a party to the burden imposed or the benefits drawn by that party.” Costs need not be allocated with “exact precision,” and we are not required to reject a rate mechanism simply because that mechanism may possibly track cost causation principles less than perfectly. As the Supreme Court found, “allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science.” “Cost itself is an inexact standard and may, in a particular set of circumstances, serve as a basis for several different rates.” Neither statutes nor court decisions “require the Commission to utilize a particular formula or a combination of formulae to determine whether rates are just and reasonable.”<sup>23</sup>

The Commission approved the netting approach as just and reasonable. Dr. Kristov has explained why the gross methodology is the most consistent with cost causation. Mr. Epstein’s declaration demonstrates that the modified gross methodology shifts the allocation significantly from the current net approach to the more causation-consistent gross approach, while providing some mitigation of excessive cost impacts<sup>24</sup>. If the modified gross approach is thus more consistent with cost-causation than the current, Commission-approved, rate, then the only reasonable conclusion is that the modified gross approach is just and reasonable.

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<sup>23</sup> *San Diego Gas & Elec. Co. v. Sellers of Ancillary Serv.*, 127 FERC ¶ 61250 at P 43 (2009) (footnotes omitted).

<sup>24</sup> See Attachment 1, Declaration of Mr. Michael K. Epstein at PP 18-26.

#### IV. CONCLUSION

For the reasons stated above, the ISO respectfully requests that the Commission approve the Offer of Settlement.

Respectfully submitted,

/s/ Michael E. Ward

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Dated: April 12, 2010

Attachment 1

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

**California Independent System     )     Docket No. ER10-188-000  
Operator Corporation             )**

**DECLARATION OF MICHAEL K. EPSTEIN  
ON BEHALF OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

I, Michael K. Epstein, state as follows:

1. I am employed as Director of Financial Planning for the California Independent System Operator Corporation (the "ISO"). My business address is 151 Blue Ravine Road, Folsom, California 95630. I am responsible for the ISO's corporate accounting, fixed assets, procurements, payables, receivables; financial, tax, and Federal Energy Regulatory Commission ("FERC" or the "Commission") reporting functions; market cash settlements; and audit coordination for all the ISO's activities.
2. I received both an MBA and a BA with a major in accounting from the University of Southern California in Los Angeles, California. Previously to my current position, I was the Controller of the ISO from 1997 - 2009. From 1994 – 1997, I was Vice President (Finance) of Siskon Gold Corporation, a publicly-traded mining company located in Grass Valley, California. From 1989 -1994, I was Controller of the Grupe Company, a privately held diversified real estate company located in Stockton,

California. From 1985-1989, I was Controller of Brush Creek Mining and Development Company located in Auburn, California. Prior to that, I was a Certified Public Accountant in the practice of public accounting with both local and international accounting firms.

3. As part of my duties at the ISO, I oversee the development of the ISO's grid management charge. The grid management charge is the mechanism by which the ISO collects its administrative costs from participants in the markets conducted by the ISO and from others that benefit from the ISO's services.
4. One part of the grid management charge is the market usage-forward energy charge, by which the ISO collects the costs of administering its forward markets.
5. The purpose of my declaration is to explain the nature of the market usage-forward energy charge, to provide the background of the allocation proposed in the Offer of Settlement, and to present the ISO's analysis of the cost-impact of options for allocating the market usage-forward energy charge.

### **BACKGROUND**

6. The CAISO Business Practice Manual for Settlements describes the market usage-forward energy charge, and the activities included in the charge, as "containing the activities associated with determining the market prices, maintaining and controlling the OASIS, monitoring market performance, ensuring generator compliance with market protocols, and

calculating the results of the Integrated Forward Market.” A list of such activities is attached to my declaration as Exhibit E-1.

7. In the summer of 2009, in fulfillment of a commitment that the ISO made during proceedings concerning the 2009 grid management charge, the ISO conducted a stakeholder process to re-evaluate the allocation of the market usage-forward energy charge, specifically with respect to whether the charge should be applied to inter-scheduling coordinator energy trades in the day-ahead market.
8. In preparing for this re-evaluation, ISO staff realized that its assessment would need to focus on the principle of cost causation and concluded that it would make no sense to artificially limit the focus just to cost causation with respect to inter-scheduling coordinator trades and not consider cost causation with respect to allocation of the market usage-forward energy charge more generally. In its own internal re-evaluation, the ISO staff concluded that cost-causation principles argued against allocation of the charge to inter-scheduling coordinator trades. It also concluded that there was a good argument that the charge should be allocated to “gross” energy schedules (representing the total quantity of each scheduling coordinator’s energy schedules in the day-ahead market, including energy sales, energy purchases, and accepted energy supply and demand self-schedules), rather than to “net” energy schedules (the result of netting energy supply schedules against energy demand schedules and taking the absolute value of the result) as in the existing tariff provisions.

9. Based on this internal evaluation, the ISO posted an issue paper posing two options for consideration and discussion at an August 18, 2009 stakeholder meeting. Both options would have removed inter-scheduling coordinator energy trades from the billing determinants to which the market usage charge code formula would be applied. The two options differed with regard to whether the market usage-forward energy charge would continue to be applied to net energy schedules or to gross energy schedules.
10. Based on stakeholder comments and a financial impact analysis provided to individual participants, the ISO posted a straw proposal on August 28, 2009. Although the ISO concluded that the “gross” option better reflected cost causation principles, it was concerned that revising the charge to apply to gross energy schedules would have a substantial rate impact on certain market participants. Because the ISO believed that rate impacts should also be taken into consideration in designing rates and choosing the billing determinants used for allocation purposes, it proposed the netting option.
11. A second stakeholder meeting was held on September 15, 2009, to discuss the straw proposal. In comments and at the meeting, some stakeholders suggested that rather than continue netting demand and supply schedules, the ISO should develop a mitigation solution that would reduce rate impacts while aligning better than the net option with the cost causation principles reflected in the gross energy option. Specifically,

- Powerex proposed that a modified form of the gross approach be adopted, under which the market usage-forward energy charge would apply only to the greater of supply or demand MWh scheduled in each trading hour of the day-ahead market.
12. Following the September 15 stakeholder meeting, ISO staff verified that the “greater of” mitigation solution was feasible and could be implemented in the ISO settlements system. The ISO conducted another stakeholder conference call on September 30, 2009, to provide an opportunity for all stakeholders to consider the proposal and ask questions.
  13. The ISO posted its final proposal on October 2, 2009, proposing (1) to eliminate inter-scheduling coordinator trades from the market usage-forward energy charge code calculation; (2) to eliminate netting from the calculation; and (3) to implement the “greater of” mitigation solution in the market usage forward energy calculation. The ISO proposed that the “greater of” mitigation solution would remain in place on an interim basis until the ISO undertook a new cost of service study during 2010 and 2011 and considered, with its stakeholders, necessary changes to the grid management charge rate design that would become effective in 2012. The basis for the ISO’s conclusion that the proposed methodology was, and is, just and reasonable is explained in the Declaration of Dr. Lorenzo Kristov.

14. On October 12, 2009, interested parties submitted comments on the final proposal. The ISO conducted a final stakeholder conference call on October 21, 2009.
15. On October 30, 2009, the ISO filed proposed tariff revisions to extend the existing grid management charge until December 31, 2010, with a revision to the market usage-forward energy charge consistent with its final proposal. Specifically, the ISO proposed to revise the allocation (1) to exclude Inter-scheduling coordinator trades from the calculation; (2) to base the charge on day-ahead energy schedules rather than purchases and sales; and (3) to calculate the charge based on the greater of a scheduling coordinator's total supply schedules or total demand schedules, rather than the difference between purchases and sales. The ISO termed this the "modified gross" approach.
16. On December 30, 2009, the Commission conditionally accepted the ISO's amendment, allowing the extension to become effective. The Commission found, however, that the ISO had failed to justify the modified gross approach as just and reasonable. The Commission noted that the ISO had not provided a cost-of-service study demonstrating that its modified gross approach to determine the market usage-forward energy charge is based on cost causation principles or any evidence regarding cost impacts.
17. Following settlement discussions under the guidance of Administrative Law Judge Judith Dowd, the ISO, on behalf of itself and eleven parties,

filed a settlement proposal implementing the modified gross approach pending the conduct of a cost-of-service study in 2010 and 2011.

### **COST IMPACT ANALYSIS**

18. For the purposes of the settlement discussion, the ISO prepared an analysis of the cost impact on various stakeholder groups of the allocation options that had been considered in the stakeholder process.
19. The ISO divided market participants into five categories: (1) investor-owned utilities, which comprised investor owned utilities that are located in the State of California; (2) suppliers, which comprised scheduling coordinators that have a generation facility physically located in the State of California; (3) municipalities, which comprised scheduling coordinators within the ISO's balancing authority area that are connected to the ISO-controlled grid and are load serving entities regulated by a federal, state, or local government; (4) marketers/importers, which comprised scheduling coordinators that schedule imports of energy into or exports of energy out of California, or participated in inter-scheduling coordinator trades; and (5) other, which comprised all other scheduling coordinators that were not clearly within one of the other groups.
20. The ISO conducted the analysis using annualized data for each scheduling coordinator for May 2009, the month for which the ISO had provided scheduling coordinators with individual cost impact information, and August and October, 2009. As part of the analysis, the ISO recalculated charges for May 2009 using the existing methodology,

because there had been a significant over collection in May 2009 as a result of the rate being too high. Using the actual May 2009 amounts would have skewed the analysis. August and October were recalculated to be consistent with May.

21. The following table sets forth the data used in the analysis:

	Current Method	Netting Method	Greater of Method	Gross Method
Amount to Recover	\$18,194,704	\$18,194,704	\$18,194,704	\$18,194,704
Three Month MWh	23,765,309	44,481,502	84,984,832	125,488,162
Total Annual Billing Quantities	95,061,236	177,926,008	339,939,327	501,952,646
Rate	\$0.1914/MWh	\$0.1023/MWh	\$0.0535/MWh	\$0.0362/MWh

22. The following table sets forth the annual cost for each group under each methodology:

Market Segment	CURRENT AMOUNT	NET AMOUNT	GREATER OF AMOUNT	GROSS AMOUNT
Investor-Owned Utilities	\$439,709	\$452,267	\$874,364	\$1,023,984
Marketers / Importers	\$544,369	\$413,295	\$221,174	\$153,073
Municipalities	\$72,826	\$78,223	\$131,128	\$149,881
Other	\$116,279	\$115,152	\$64,265	\$46,227
Suppliers	\$226,315	\$264,728	\$140,447	\$96,393

23. The annual costs for each group are depicted in the charts attached to my declaration as Exhibit E-2.

24. Finally, the following table sets for the cost impact on each group compared to the current methodology:

Market Segment	NETTING APPROACH	GREATER OF APPROACH	GROSS APPROACH
Investor-Owned Utilities	+2.86%	+98.85%	+132.88%
Marketers / Importers	-24.08%	-59.37%	-71.88%
Municipalities	+7.41%	+80.06%	+105.81%
Other	-0.97%	-44.73%	-60.24%
Suppliers	+16.97%	-37.94%	-57.41%

25. The cost impact for each group is depicted in the charts attached to my declaration as Exhibit E-3.

26. As is apparent from these tables and charts, changing from the current approach to the gross methodology, which the ISO concluded was the most consistent with cost causation, has an enormous adverse impact on load-serving entities, both investor-owned and municipal. The modified gross, or greater of, methodology, also has a major impact, in the same direction, but mitigates that impact somewhat.

I hereby certify under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge, information, and belief:

Executed on: April 12, 2010

/s/ Michael K. Epstein  
Michael K. Epstein

## EXHIBIT E-1

### MARKET USAGE-FORWARD ENERGY ACTIVITIES

- Manage transmission and generation schedules:
  - Day and HASP schedules (including Participating Intermittent Resources)
  - Determine schedule feasibility
- Manage congestion Day Ahead
- Monitoring and reporting on congestion management market performance
- Investigating and reporting on potential gaming and market power abuses (congestion)
- Perform weekly, daily and hourly load forecasting
- Operate A/S and Real-Time markets
- Determine market clearing prices (A/S and Energy)
- Mitigate bids (real time and forward)
- Maintenance of market information postings (transmission/market OASIS)
- Operate unit commitment service under SMD
- Mitigate market power in Day-Ahead Market, HASP and Real Time Market
- Develop and manage demand response participation
- Administer Congestion Revenue Rights:
  - Perform CRR allocation (Primary)
  - Coordinate CRR bilateral trading (Secondary)
  - Calculate and determine feasibility of CRR capacity
- Monitor and report on market performance
- Investigate and report on potential gaming and market abuses
- Perform special studies on market efficiency, bidding behavior
- Develop new market rules or changes to market rules in response to market behavior
- Prepare and provide reports to regulatory authorities
- Implement and calculate penalties and sanctions for noncompliance

## Attachment 2

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

**California Independent System     )     Docket No. ER10-188-000  
Operator Corporation             )**

**DECLARATION OF LORENZO KRISTOV  
ON BEHALF OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

I, Lorenzo Kristov, state as follows:

1. I am employed as Principal, Market and Infrastructure Policy, within the Market and Infrastructure Development Division at the California Independent System Operator Corporation (the "ISO"). My business address is 151 Blue Ravine Road, Folsom, California 95630. In my position, I am responsible for (1) developing ISO policies related to the core ISO functions of operating efficient spot markets and planning transmission infrastructure enhancements, and (2) designing new market elements and planning processes and improvements to existing elements and processes.
  
2. I received a master's degree in Statistics from North Carolina State University and a Ph.D. in Economics from the University of California at Davis. I have worked for the ISO since 1999, initially with the Department of Market Analysis and, subsequent to an internal reorganization, at my current position. I was one of the principal designers and developers of the ISO's new market structure based on locational marginal pricing,

which began as congestion management reform at the beginning of this millennium, evolved into the Market Design 2002 initiative, was eventually renamed the Market Redesign and Technology Upgrade, and was implemented on April 1, 2009.

3. Prior to my work at the ISO, I worked for the California Energy Commission from 1991 to 1993 on demand forecasting. In 1993 and 1994, I worked in Indonesia as a Fulbright scholar on the development of a commercial and regulatory framework to support private power investment. From 1995 until I started working at the ISO, I again worked at the California Energy Commission, where I represented the Commission in all electric restructuring proceedings at the California Public Utilities Commission and in related stakeholder working groups that were developing the rules for retail direct access.
4. The purpose of my declaration is to explain the basis for the ISO's conclusion that the allocation of the market usage-forward energy charge proposed in the Offer of Settlement is appropriately consistent with cost causation principles while mitigating excessive cost impacts on load-serving entities resulting from the transition from the current allocation method.
5. As explained in the declaration of Michael Epstein, the ISO undertook its recent reassessment of the existing method of allocating the market usage-forward energy charge in response to arguments by some market

participants that inter-scheduling coordinator trades should not figure into the calculation of either the rate for the market usage-forward energy services charge or the volume to which the rate is applied. In order to properly assess the merits of this argument and determine whether to propose a change to the cost allocation methodology for this charge, the ISO necessarily had to examine the cost causation basis for calculating both the rate and the allocation. This inquiry led beyond the initial question of the appropriateness of including inter-scheduling coordinator trades to a complete reevaluation of the cost causation basis for calculating and allocating the market usage-forward energy charge.

6. Under cost causation principles as I understand them, rates serve to allocate the costs of providing a service to those that cause the cost to be incurred by using the service and thereby receive the benefits of the service, in proportion to each party's use of or benefits from the service. As the Commission stated in Opinion No. 463, another proceeding concerning the ISO's grid management charge, "While this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which "should be borne by those who benefit from them. . . . [T]he initial decision [in that proceeding] accurately characterized cost causation and received benefits as alternate means of expressing the same benefit."<sup>1</sup>

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<sup>1</sup> *Cal. Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,114 at P 26 (2003).

7. Consistent with our understanding of these principles, and recognizing that the determination of cost causation is rarely if ever an exact science, the ISO's objective in considering the inter-scheduling coordinator trade issue was to allocate the market usage-forward energy charge as closely as possible in proportion to each scheduling coordinator's use of the services paid for by that charge, taking into account any other relevant factors.
8. As explained in greater detail in Mr. Epstein's declaration, the market usage sub-function consists of the services the ISO performs in processing Energy and Ancillary Services bids, executing the security constrained unit commitment procedures, managing congestion and creating feasible energy schedules, determining market clearing prices, maintaining and operating the Open-Access Same-Time Information System, monitoring market performance, and ensuring compliance with market protocols. I should explain in this regard that "bids" is a defined term in the ISO Tariff. It includes both bids that specify quantities and source or sink locations without any associated prices – what might otherwise be called supply schedules and demand schedules – and bids that also include prices, *i.e.*, offers to sell or purchase energy.
9. The costs of providing these services are closely, although not perfectly, correlated to the amount of energy for which the services are performed, meaning that they increase or decrease directly as a function of the total volume of energy cleared and scheduled in the ISO markets.

10. By design, the ISO's current market systems for clearing energy bids and managing congestion treat each demand and supply bid as a distinct transaction to be processed. Thus, the submission by a scheduling coordinator of both supply and demand bids does not result in some sort of "net" impact on the market, but rather contributes to the scheduling coordinator's market usage in proportion to the sum of its supply and demand quantities.
  
11. In contrast, inter-scheduling coordinator trades are not considered in any of the central market functions such as the security constrained unit commitment, the clearing of the energy market or the management of congestion. Inter-scheduling coordinator trades are purely financial transactions between two counter-parties, whereby the ISO settlement system charges an amount of money to one party and pays the same amount to the other party (after assessing targeted transaction charges). This is true even for those inter-scheduling coordinator trades that the ISO classifies as "physical trades." Although the physical trade does involve verification of a physical energy supply schedule behind the supply side of the trade, such verification is for settlement purposes only and does not figure into the market functions noted above. Thus the use of inter-scheduling-coordinator trades by a scheduling coordinator does not rely on the services paid for by the market usage-forward energy charge, and the ISO appropriately does not recover the costs of processing inter-scheduling coordinator trades through the market usage-forward energy

charge. Based on these facts, the ISO concluded that the cost causation principle would be better served by modifying the existing allocation of this charge to exclude inter-scheduling coordinator trades from the calculation of both the rate and the individual scheduling coordinator shares of the charge.

12. The allocation proposed by the ISO in the October 31, 2009, filing therefore did not include inter-scheduling coordinator trades in the volumes used to calculate the market usage-forward energy charge rate or in the volumes used to assess the charge to individual scheduling coordinators. The Offer of Settlement adopts the same approach and the ISO therefore believes, for the same reasons, that it is just and reasonable.
  
13. Also, based on the nature of the services for which the ISO assesses the market usage-forward energy charge and on the use of those services to clear and schedule total quantities of energy supply and demand, the ISO concluded that allocating the costs according to the sum of demand and supply schedules would be most consistent with cost causation. As I stated above, the submission by a scheduling coordinator of both supply and demand bids, does not in any way “net” the scheduling coordinator’s use of the market services paid for through the market usage-forward energy charge. Rather, each participant’s market usage is a function of the gross total of its cleared energy supply and demand bids. Netting the charge would not reflect this use of market services. Under netting, the

ISO would charge a scheduling coordinator that cleared ten MWh of supply only in the market based on ten MWh, but would charge nothing to the scheduling coordinator that cleared five MWh of supply and five MWh of demand, even though both scheduling coordinators received equivalent services.

14. Although the ISO concluded that summing the demand and supply schedules – the “gross” approach – would best match the charges with each party’s use of the services, the ISO recognized that eliminating the current practice of netting and moving directly to the gross approach could result in substantial rate impacts for some scheduling coordinators, particularly load-serving entities. These impacts are explained in Mr. Epstein’s declaration. The ISO was reluctant to impose such extensive impacts on load-serving entities in a single step at this time, particularly in light of the fact that the ISO is planning to conduct a full cost-of-service study in 2010-11 for considering ways to better align the grid management charge with cost causation principles, for application beginning in 2012.
15. The ISO therefore evaluated an alternative proposed in the stakeholder process by Powerex, which would allocate the market usage-forward energy charge according to the greater of a scheduling coordinator’s total demand schedules or total supply schedules. As shown in Mr. Epstein’s charts, using this allocation instead of the current allocation would shift charges significantly in the same direction as the gross approach, but would mitigate the cost impacts somewhat.

16. Based on its understanding of Commission precedent, the ISO did not believe that a rate need adopt the one methodology most reflective of cost causation in order to be just and reasonable. For example, while, as I stated earlier, the cost of the market usage-forward energy charge is most closely correlated with the amount of energy for which the services are provided, the correlation is not perfect. During the ISO's next cost-of-service study, I anticipate that the ISO will examine whether consideration of other variables or other charges could produce a closer alignment. Nonetheless, the ISO believes basing the charge on the energy cleared in the ISO markets complies with cost causation principles.
17. For the same reasons, the ISO believed it could take other considerations into account as long as the allocation remained largely proportional to the receipt of services. The ISO concluded that, as an interim measure pending the complete cost-of-service study, the "greater of" approach proposed by Powerex would be a just and reasonable allocation that avoided excessive impacts on load-serving entities.
18. The Offer of Settlement adopts that same "greater of" approach that the ISO proposed in its October 31, 2009, filing. For the reasons I have discussed, therefore, the ISO believes that Offer of Settlement is just and reasonable.

I hereby certify under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge, information, and belief:

Executed on: April 12, 2010

/s/ Lorenzo Kristov

Lorenzo Kristov

## CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of this document to be served upon each person designated on the official service list for the above-referenced 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 this 12<sup>th</sup> day of April, 2010, at Washington, DC.

/s/ Michael Ward

Michael Ward  
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