



California Independent
System Operator Corporation

March 12, 2007

The Honorable Philis J. Posey
Acting Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation
Docket Nos. ER07-475-___, RM06-8-___
Long-Term Firm Transmission Rights in Organized Electricity Markets

Dear Secretary Posey:

Enclosed for filing in the above-referenced docket is the California Independent System Operator Corporation's Motion for Leave to File Answer and Answer to Motions to Intervene, Comments, and Protests.

Thank you for your assistance in this matter.

Respectfully submitted,

/s/ Anna McKenna
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**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System) Docket No. ER07-475-__
Operator Corporation)

Long-Term Firm Transmission Rights) Docket No. RM06-8-__
In Organized Electricity Markets)

**MOTION FOR LEAVE TO FILE ANSWER AND ANSWER TO MOTIONS TO
INTERVENE, COMMENTS AND PROTESTS OF THE CALIFORNIA
INDEPENDENT SYSTEM OPERATOR CORPORATION**

I. INTRODUCTION.

On January 29, 2007, the California Independent System Operator Corporation (“CAISO”) submitted its filing in compliance with Order Nos. 681 and 681-A, the Federal Energy Regulatory Commission’s (“FERC” or the “Commission”) Final Rule regarding Long-Term Firm Transmission Rights in Organized Electricity Markets (“January Filing”).¹ The CAISO’s proposal to implement long-term firm transmission rights is an extension of the Congestion Revenue Rights (“CRRs”) program under the Market Redesign and Technology Upgrade (“MRTU”) Tariff.² The Long Term Congestion Revenue Rights (“Long Term CRR”) proposal incorporates the provision of long-term firm transmission rights into the CRR allocation process under the MRTU Tariff conditionally approved by the Commission.³ In so doing, the CAISO’s January 29 Filing complies with FPA Section 217 and the seven Commission

¹ *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 71 FR 43564 (Aug. 1, 2006), FERC Stats. & Regs. ¶ 31,226 (2006) (“Order No. 681” or “Final Rule”); and Order No. 681-A, 117 FERC ¶ 61,201 (2006) (“Order No. 681-A” or “Rehearing Order”).

² *See generally* Docket No. ER06-615-000.

³ *California Independent System Operator Corporation*, 116 FERC ¶ 61,274 (September 21, 2006) (“September 21 Order”). One of the primary drivers of the MRTU as described in the CAISO’s February 9, 2006 filing in Docket No. ER06-615-000 (“MRTU Filing”) is to encourage long-term contracting and ease pressure on spot markets. *See generally* Testimony of Scott Harvey and Susan Pope, Docket No. ER06-615-000, Exh. ISO-2 at p 27.

guidelines set forth in Order No. 681 and as further clarified in Order No. 681-A. In response to the January Filing, a number of parties submitted motions to intervene, comments, and protests.

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2005), the CAISO hereby requests leave to file this answer to the comments, protests and motions to intervene submitted in the above-referenced proceeding. The ISO requests waiver of Rule 213(a)(2) (18 C.F.R. § 385.213(a)(2)) to permit it to make an answer to the protests. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case.⁴ To that end, the CAISO's answer only addresses issues that serve to correct misconceptions raised in comments and protests or otherwise help clarify the record.⁵ In addition, the CAISO will address a few discrete issues on which it proposes minor modifications from its filed Long Term CRR proposals in response to stakeholder comments.

II. EXECUTIVE SUMMARY.

This answer provides additional information on sixteen issues raised by interveners, and, as explained in more detail herein, the CAISO requests that the Commission approve the January Filing as proposed. However, the CAISO also notes that there are two issues on which interveners commented and for which the stakeholder process is continuing. The issues involve

⁴ See, e.g., *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Company*, 93 FERC ¶ 61,098, at 61,259 (2000).

⁵ The fact that the CAISO has not addressed every issue in the protests and comments should not be deemed to be agreement or acquiescence by the CAISO on the issues not addressed.

the restriction on using Trading Hubs as a source for Long Term CRRs and the historical reference period to be used to verify sources for Long Term CRRs.⁶

With regard to Trading Hubs, the January Filing proposed to prohibit the use of Trading Hubs as source locations for Long Term CRRs. This policy decision was made to address two phenomena that were identified in the CRR Dry Run process (a process the CAISO conducted with market participants starting in spring of 2006 for the purpose of end-to-end testing of the filed CRR rules and processes). At the time of this filing, the CAISO is continuing to assess the CRR Dry Run results and explore whether it will be able to propose changes that can either reduce or eliminate the reasons for the restriction on using Trading Hubs as sources for Long Term CRRs. No later than May 2, 2007, the CAISO will inform the Commission whether the originally-filed restriction on use of Trading Hubs as sources for Long Term CRRs will remain as-filed or whether any changes are necessary to allow the use of (or reduce the restriction on) Trading Hubs as source for Long Term CRRs.⁷

With regards to the historical reference period used to verify sources for Long Term CRRs, the CAISO stated its intent in the January Filing to change the historical period used to verify sources for all CRR nominations from the 2004-2005 period specified in the MRTU Filing to a calendar year 2006 historical period.⁸ More recently some stakeholders have suggested and the CAISO is considering certain modifications to the rules regarding the universe of supply arrangements that may be counted for verification purposes. The specifics are described later in

⁶ See Sections III.A (Trading Hubs) and III.B (historical reference period for source verification) of this pleading, *infra*.

⁷ Any changes to the prohibition on the use of Trading Hubs as sources for Long Term CRRs will be filed with the Commission by May 2, 2007 or sooner so that the CAISO may conduct its first annual CRR Allocation and CRR Auction later this summer.

⁸ See Transmittal Letter to January Filing at p. 27.

this pleading. As of the date of this pleading, the stakeholder process on this matter is still in progress. As with the Trading Hub issue, any Board-approved changes to the rules regarding the use of the historical reference period for source verification will be filed with the Commission no later than May 2, 2007 in order to implement the CAISO's source verification process in time to conduct the first annual CRR Allocation and CRR Auction later this summer.

III. ANSWER.

A. Trading Hub Restriction

As noted in the January Filing, Trading Hubs cannot be used as source locations for Long Term CRRs under the CAISO's proposal.⁹ This policy decision was made to address two phenomena that were identified in the CRR Dry Run, which the CAISO conducted with market participants starting in spring of 2006 for the purpose of end-to-end testing of the filed CRR rules and processes.¹⁰ The two phenomena of concern affect the allocation of all CRRs, not just Long Term CRRs, but due to the 10-year duration of Long Term CRRs the adverse impact of these phenomena could be long-lived. Hence the CAISO made a policy decision not to release Long Term CRRs sources at Trading Hubs.

A number of parties object to the CAISO's proposal to prohibit sourcing Long Term CRRs at Trading Hubs. Some parties object to the exclusion of Trading Hubs as sources for Long Term CRRs and request that FERC either order the removal of this restriction or order the

⁹ Transmittal Letter to January Filing at p. 25; *see* proposed tariff § 36.8.4. Dr. Lorenzo Kristov discussed this issue in his Direct Testimony. *See* Exh. No. ISO-1 at 53-56.

¹⁰ The two phenomena of concern were observed in the first two tiers of the annual CRR allocation process. First, in the Simultaneous Feasibility Test (SFT) for CRR allocation, CRR nominations from the specific generator PNodes associated with binding constraints will typically and consistently be reduced prior to CRR nominations from EZGen Hubs due to the far greater effectiveness of the former on the associated binding constraints. Second, once such a constraint becomes binding, which may occur in Tier 1 of the allocation process, no additional Trading Hub CRRs can be allocated in subsequent tiers unless that nominated CRR has a zero shift (or distribution) factor over the binding constraint. The CAISO will file a complete report on the CRR Dry Run with the Commission on April 30.

CAISO to delay Long Term CRRs until the Trading Hub problems can be fixed.¹¹ Other parties argue that restricting Long Term CRRs from sourcing at Trading Hubs will devalue the use of hubs in the MRTU design.¹² Other parties argue that, without Trading Hubs as Long Term CRR sources, the core bargain of the Seller's Choice settlement¹³ will be upset.¹⁴ Others raise concerns that the Trading Hub restriction will disproportionately impact small load-serving entities ("LSEs").¹⁵ Still other parties argue that the formulation of Trading Hubs in the MRTU market should be revisited in lieu of restricting long-term transmission rights.¹⁶

As part of its assessment of the CRR Dry Run results, the CAISO is working with stakeholders to see if there are revisions to the rules governing source nominations for the annual CRR allocation process that would mitigate effects observed in the CRR Dry Run. Any revisions could apply to the tiered allocation process for Seasonal and Monthly CRRs that the Commission conditionally approved in the September 21 Order and/or to the process for allocating Long Term CRRs proposed in the CAISO's January 29, 2007 filing. The effort is ongoing and the CAISO believes changes are likely with regard to the annual allocation process for Seasonal and Monthly CRRs in Tier 1, Tier 2, and Tier 3 of the allocation process.

¹¹ AReM at 6.

¹² Calpine at 2; WPTF at 5-6; CMUA at 18.

¹³ *See California Independent System Operator Corp.*, 111 FERC ¶ 61,385 (2005); and *California Independent System Operator Corp.*, 111 FERC ¶ 61,386 (2005).

¹⁴ Calpine at 2; WPTF at 9. Although the CAISO is investigating the feasibility of removing the restriction on the use of Trading Hubs as sources for Long Term CRRs, the CAISO does not believe that the restriction implicates the validity of, or undermines the balance of benefits and burdens of the Seller's Choice settlement. In contrast, if there were a change, *e.g.*, to the method by which prices at Trading Hubs are calculated such a change could upset the Seller's Choice settlement and would require the consent of the settling parties.

¹⁵ WPTF at 7. For the purposes of this filing, the term "LSE" will be used in the generic sense, rather than referring simply to load internal to the CAISO Control Area.

¹⁶ WPTF at 7.

With regard to Long Term CRRs, the CAISO is exploring whether CRRs sourced at Trading Hubs and distributed in the annual allocation process can be nominated as Long Term CRRs. At the time of this filing, the CAISO is continuing to explore whether it will be able to propose changes that can either reduce or eliminate the reasons for the restriction on using Trading Hubs as sources for Long Term CRRs included in its January 29, 2007 filing. The CAISO expects it will be able to post its proposal on possible CRR rule changes from lessons learned in the CRR Dry Run in April. The CAISO is working through these possible rule changes within its stakeholder process to ensure that the issues have been fully vetted with stakeholders in the time permitted. Any rule changes that affect the use of Trading Hubs as they pertain to all CRRs, including Long Term CRRs, will be finalized by April 18, 2007 as that is the day on which the CAISO will be seeking any necessary Board approval for any rule changes that alter MRTU policy as previously approved by its Board. The CAISO anticipates it will be making a filing by May 2, 2007 to capture all such rule changes. In the May 2, 2007 filing, the CAISO will inform the Commission whether the originally-filed restriction on use of Trading Hubs as sources for Long Term CRRs will remain as filed or whether any changes are necessary to allow the use of (or reduce the restriction on) Trading Hubs as source for Long Term CRRs.

B. The CAISO's Historical Reference Period for Allocating CRRs, Including Long Term CRRs, is Just and Reasonable

In the MRTU market design, nominations for CRRs in Tiers 1 and 2 of the Year One annual and monthly allocation processes must be source verified by demonstrating either (a) ownership of, or contracted energy delivery from, generating resources or (b) contractual rights to take ownership of power at the relevant source such as a Trading Hub or Scheduling Point.¹⁷

¹⁷ MRTU Tariff § 36.8.3.4.

The CAISO's MRTU Tariff uses a historical reference period to conduct the source verification. Under the Long Term CRR proposal, the source verification process still plays an important role, because CRRs awarded in the source verified allocation tiers will be eligible for nomination as Long Term CRRs.¹⁸

In the January Filing, the CAISO stated its intent to change the historical period used to verify sources for all CRR nominations from the 2004-2005 period specified in the MRTU Filing to a calendar year 2006 historical period.¹⁹ While some parties support the change to a 2006 historical reference period,²⁰ others object to using 2006 or limiting the historical reference period to a single year.²¹ For example, Six Cities urge the Commission to approve an historical reference period that encompasses the months that have already been approved for this purpose (i.e., September 2004 through August 2005) plus the remaining months of 2005 and all of calendar year 2006, so that the entire 28-month historical reference period for source validation would be September 2004 through December 2006.²² San Diego Gas and Electric Company (SDG&E) notes that it participated in the stakeholder process regarding how the allocation of Long Term CRRs could be integrated into the still evolving process contemplated for short-term CRRs.²³ SDG&E also stated that it was encouraged by the CAISO's recognition that further work was required to ensure that the "short and long-term CRR allocation process will produce results that are fair and equitable."²⁴ SDG&E's main and "growing" concern was:

¹⁸ See Dr. Kristov's discussion of this issue at Exh. No. ISO-1 at pp. 30-31.

¹⁹ See Transmittal Letter to January Filing at p. 27.

²⁰ SWP at 2.

²¹ See generally Six Cities at 7-8.

²² Six Cities at 8.

²³ SDG&E at 3.

²⁴ *Id.*

based on the most recent CRR dry-run results, that use of a recent and relatively brief “historical period” for purposes of verifying and validating priorities to Tier 1 and Tier 2 CRRs *would leave SDG&E with relatively few valuable congestion cost hedges on the interties.*²⁵

SDG&E offers a number of solutions to address the inequity it sees with the historical reference period for source verification for Long Term CRRs and the effects of that period on SDG&E being able to hedge its congestion costs on a long term basis at the Interties.²⁶ With its first proposed solution SDG&E states that given the increasing emphasis on long-term procurement by LSEs with a priority to enlarging the portfolio of renewable projects to serve California’s needs, the CRR source verification process should be linked to the ten-year procurement plans filed by the CPUC-jurisdictional LSEs in December 2006. Specifically, SDG&E recommends that “[l]oad-serving entities should be granted a *CRR validation priority for resources that they own, or have under construction or contract as of December 2006, the date that the investor-owned utility’s procurement plans were filed at the CPUC.*”²⁷

The CAISO’s decision to change the historical reference period to calendar year 2006 was based on numerous stakeholder comments that the September 1, 2004 to August 31, 2005 period was too far in the past relative to the start of MRTU. The choice of calendar year 2006 brings the historical reference period as up-to-date as possible without violating the principle that source verification be based on supply decisions made in the past. Thus, the CAISO’s choice of a reference period reflects Dr. Susan Pope’s expert opinion regarding the efficiency properties of using a past period.²⁸ It is important in Dr. Pope’s opinion to pick a past period so that the opportunity to be allocated CRRs does not alter supply decisions or otherwise contaminate the

²⁵ *Id.* (emphasis added).

²⁶ *Id.* at 10-12.

²⁷ *Id.* at 10.

²⁸ *See* Dr. Pope’s testimony, Exh. No. ISO-2 at pp. 32-33.

bilateral contracting process. These economic efficiency concerns were also discussed in detail in the testimony of Dr. Susan Pope and Dr. Scott Harvey filed in conjunction with the February 2006 MRTU Tariff.²⁹

The requirement to use a past time period as the reference for source verification does not necessarily require, however, that only contracts for energy delivery during that time period can be considered as the basis for CRR allocation, as the filed MRTU Tariff requires. Therefore, the CAISO has been assessing, in the context of the current stakeholder process, the possibility of adopting a modified version of one of SDG&E's proposals. As noted earlier, SDG&E proposed that the CAISO base source verification on the ten-year procurement plans filed by the CPUC-jurisdictional LSEs in December 2006. These plans include supply contracts that were signed during the calendar 2006 reference period – and thus do not violate the economic efficiency concerns noted above – but will not deliver energy until a specified future date. The CAISO is therefore considering a variant of the SDG&E proposal that would not be exclusive to CPUC-filed plans, but would allow LSEs to submit as verified sources any contracts signed during the 2006 reference period for delivery of energy starting within a specific time horizon in the future. The appropriate time horizon to use will be a topic in the upcoming stakeholder discussions on this topic.

The CAISO emphasizes, however, that this proposal requires further assessment before the CAISO can formally propose to change its filed source verification rules in this manner. Moreover, the CAISO remains convinced that the original source verification approach filed in February 2006, which allows only sources that delivered energy during the historical reference

²⁹ See Prepared Direct Testimony of Scott M. Harvey and Susan L. Pope in Docket No ER06-615-000, Exh. ISO-2 at pp 109-110.

period, would still be sufficient and appropriate under a CRR construct where the time horizon for release of CRRs is only one year in the future. With the inclusion of Long Term CRRs in the MRTU design, however, the change under consideration may be an effective way to allow LSEs to obtain Long Term CRRs sourced at locations where future supplies will be delivered without undermining economic efficiency in the bilateral contracting process.

The CAISO must also point out that the proposed expansion of the set of eligible sources for verification is not without concerns, which will affect the CRR allocation processes for both Long Term CRRs and the shorter-term instruments. Specifically, once the reference period admits sources that deliver energy over a period greater than one year it becomes possible, even likely, that some sources will be counted more than once. For example, Generator A with 100 MW capacity contracts to deliver 100 MWh of energy to LSE 1 during 2006 and 100 MWh of energy to LSE 2 during 2008. If both LSEs can nominate 100 MW of CRRs sourced at Generator A, the 200 MW of CRR nominations will most likely be infeasible and the two LSEs may receive considerably less than their verified amounts. Such concerns must be thoroughly vetted with stakeholders before the CAISO is ready to formally propose to adopt this approach.

The CAISO does not support Six Cities' proposal to approve an historical reference period that encompasses the months that have already been approved for this purpose (*i.e.*, September 1, 2004 to August 31, 2005) plus the remaining months of 2005 and all of calendar year 2006.³⁰ Six Cities proposal to create a 28-month historical reference period obviously encompasses a longer period of procurement practices. In contrast to the CAISO's consideration of expanding the horizon for verification of sources by looking forward in time as described above, the CAISO believes that expanding the horizon in the backward direction is not

³⁰ Six Cities at 8.

appropriate, and would most likely lead to even greater multiple counting of sources than the forward look. The reason is that in the forward direction there will be new supply sources coming on line to meet future supply contracts, in many cases associated with new renewable energy sources. Moreover, the MW quantity of contracts signed in 2006 that specify precise delivery locations and starting delivery dates will be only a portion of any given LSE's overall eligibility for CRR allocation. When the verification time horizon is expanded in the backward direction, however, the expansion will include only resources that already exist, and could add quantities that are double each LSE's eligible quantity or even greater. The CAISO therefore believes that this proposal should be rejected.

As of the date of this pleading, the stakeholder process is continuing with regard to the historical reference period and the consideration of a proposal that would allow LSEs to submit as verified sources any contracts signed during the 2006 reference period for delivery of energy starting within a specific time horizon in the future. The CAISO anticipates that its proposal on any CRR rule changes from lessons learned from the CRR Dry Run in April will include any changes to the verification rules associated with the historical reference period. Any necessary changes to the historical reference period will be sought on April 18, 2007 at the CAISO's Board meeting. Any Board-approved changes to the historical reference period for source verification will be filed with the Commission by May 2, 2007 or sooner in order to implement its source verification in time for it to conduct its first annual CRR Allocation and CRR Auction later this summer.

C. The 10-Year Term of Long Term CRRs Satisfies the Final Rule and Is Otherwise Just and Reasonable.

Guideline No. 4 of the Final Rule provided that, “[t]ransmission organizations may propose rules specifying the length of terms and use of renewal rights to provide long-term

coverage, but must be able to offer firm coverage for at least a 10 year period.” The CAISO’s Long Term CRRs have terms of ten-years for each season and time of use period and are renewable upon expiration, subject to simultaneous feasibility.³¹ In response to the CAISO’s proposal to give Long Term CRRs a 10-year term, several parties that argue that a 10-year term is not sufficiently flexible to satisfy the Final Rule. Certain parties argue that Long Term CRRs should be able to have terms of longer than 10 years and be available for periods shorter than 10 years, depending on the resource procurement needs of the load-serving entity.³² Other parties argue that Long Term CRRs should be renewed automatically after expiration.³³ CMUA argues that the Long Term CRRs the CAISO will offer are not “equal to or superior” to OATT service under Order No. 890.³⁴ While some parties support the flexibility offered by varying Long Term CRRs by season and time of use period (*i.e.* peak and off-peak),³⁵ others express concern that those variations will allow LSEs to “cherry pick” the more valuable and useful Seasonal and Long Term CRRs.³⁶

The CAISO continues to believe that the 10-year term of Long Term CRRs satisfies the Final Rule and is otherwise a reasonable term length. Moreover, the seasonal and time-of-use structure of Long Term CRRs is essential to a fundamental principle the CAISO followed in developing the Long Term CRR proposal, namely, to provide a balanced, unbiased process for LSEs to obtain their individual, preferred mix of Long Term and Seasonal CRRs and preferred

³¹ See Transmittal Letter to January Filing at pp. 20-21. The 10-year term is accomplished in the tariff through revisions to Section 36.3.2 of the MRTU Tariff.

³² TANC at 6; Santa Clara at 5-6.

³³ PG&E at 4-6.

³⁴ CMUA at 15-17.

³⁵ NCPA at 9

³⁶ Powerex at 27.

balance between ten-year certainty and flexibility. In response to parties that ask for flexibility to obtain Long Term CRRs for periods shorter than 10 years, the CAISO points to, first, the Priority Nomination Process (“PNP”) of the annual allocation process, which affords LSEs a high degree of certainty in the ability to renew Seasonal CRRs for only as many years as their supply arrangements require. Second, the LSE also can obtain CRR coverage for a period shorter than ten years by obtaining a Long Term CRR and then offering the unneeded years into the annual CRR auction process or by engaging in a bilateral sale, as described fully in the CAISO’s filed proposal. In response to parties that ask for flexibility to obtain Long Term CRRs for periods longer than 10 years, the CAISO points to the ability of the LSE to renew a Long Term CRR in its final year by nominating the same source, sink, and MW terms of the Long Term CRR in the PNP and receiving a Seasonal CRR, and then nominating and receiving a new Long Term CRR in the Tier LT process. While this approach does subject the renewal to an SFT and thus is not an absolute guarantee of renewal, the LSE wishing to renew the Long Term CRR does benefit from the high degree of certainty designed into the rules for the PNP.

Regarding PG&E’s request that holders of Long Term CRRs should be guaranteed renewal, the CAISO appreciates the reasons behind PG&E’s comment and acknowledges that ISO New England’s proposed long-term rights are five-year instruments with guaranteed additional five-year terms (so long as the holder maintains eligibility). Without speaking to the merits of ISO New England’s proposal, the CAISO believes its ten-year term as proposed is just and reasonable for its purposes for the following two reasons: First, under the CAISO’s filing Long Term CRRs are capable of being renewed using the PNP and, as noted above, with the PNP it is highly likely that an LSE will be able to renew its Long Term CRR for subsequent 10-

year terms.³⁷ Second, guaranteed renewal raises a couple of concerns. Guaranteed renewal may violate simultaneous feasibility and could therefore lead to CRR revenue shortfalls which, under the full-funding provisions, would increase the CRR uplift payment by all load. Dr. Pope notes in her testimony that the appropriate way to guarantee renewal of Long Term CRRs without undermining simultaneous feasibility and revenue adequacy would be to model the option to renew in the SFTs for years beyond the expiration of previously released Long Term CRRs.³⁸ Dr. Pope indicates that this would significantly increase the complexity of the simultaneous feasibility tests for Long Term CRRs because in order to ensure simultaneous feasibility of such options the CAISO would need to model each LSE's option to renew at the end of the Long Term CRR's term. In addition to the complexity of such a process, this renewal option would likely reduce the overall amount of Long Term CRRs available to all LSEs.³⁹

CMUA argues that the 10-year term for Long Term CRRs and the Priority Nomination Process are not "as good or superior to" OATT service required under Order No. 890. CMUA requests that the Commission order the CAISO to make a compliance filing either explaining why its current treatment of renewal rights is as good or superior to OATT service, or proposing modifications to ensure renewal rights for Long Term CRRs.⁴⁰ AS CMUA knows, the CAISO is required to make a compliance filing within 210 days of the publication of Order No. 890 in the Federal Register. In that filing the CAISO can either file the non-rate terms and conditions set forth in the Final Rule or demonstrate that its existing tariff provisions are consistent with or

³⁷ See Dr. Kristov's testimony, Exh. No. ISO-1 at p. 50; see also Attachment F to the January 29 Filing (Whitepaper on Long Term Congestion Revenue Rights) at pp. 14-15.

³⁸ See Dr. Pope's testimony, Exh. No. ISO-2 at pp. 67-68.

³⁹ *Id.* at 67. The reason the Long Term CRR awards could be reduced is because guaranteed renewal would require the Long Term CRRs to be simultaneously feasible for any combination of Long Term CRRs that other load serving entities choose to roll over. *Id.* at 68.

⁴⁰ CMUA at 17.

superior to the revised provisions of the pro forma OATT.⁴¹ Furthermore, the Commission stated that some of the changes adopted in Order No. 890 may not be as relevant to ISO/RTO transmission providers as they are to non-independent transmission providers. The Commission recognized that:

. . . many ISOs and RTOs use bid based locational markets and financial rights to address transmission congestion, rather than the first-come, first-served physical rights model set forth in the pro forma OATT. As we indicated in the NOPR, nothing in this rulemaking is intended to upset the market designs used by existing ISOs and RTOs. We also recognize that ISOs and RTOs may well have adopted practices that are already consistent with or superior to the reforms adopted here.

Order No. 890 at P 158. CMUA’s comments about Long Term CRR renewal rights and renewal rights under the *pro forma* OATT are more appropriately addressed in an Order No. 890 compliance filing.

D. The CAISO’s Allocation of Long Term CRRs to Out of Control Area Load-Serving Entities Should be Approved as a Reasonable Extension of the MRTU Provisions Allocating Seasonal and Monthly CRRs to Those Same Entities.

Under the conditionally-approved MRTU Tariff, Seasonal and Monthly CRRs are available on a non-discriminatory basis to eligible load-serving entities from: (a) sources internal to the CAISO Control Area to sinks within the CAISO Control Area, (b) Scheduling Points at the external interties of the CAISO Control Area to sinks within the CAISO Control Area, and (c) sources internal to the CAISO Control Area to Scheduling Points at the external interties of the CAISO Control Area (*i.e.*, enabling CRRs to be allocated to Out-of-Control Area Load-Serving Entities or “OCALSEs”). Regarding the latter category (*i.e.*, CRRs from sources internal to the CAISO Control Area to Scheduling Points at the external interties of the CAISO Control Area)

⁴¹ Order No. 890 at P 157.

OCALSEs are required to make a showing of legitimate need for the nominated CRRs nominated, and pre-pay the appropriate Wheeling Access Charge in the amount of MWs of the nominated CRRs.⁴² The requirements for OCALSEs were objected to by several interveners in the MRTU proceeding and, notwithstanding these objections, conditionally-approved as reasonable by the Commission in the September 21 Order.⁴³

The CAISO's Long Term CRR proposal is an extension of the allocation process for allocating Seasonal and Monthly CRRs to OCALSEs. OCALSEs are eligible to nominate Long Term CRRs just as those entities are eligible to nominate Seasonal and Monthly CRRs.⁴⁴ An OCALSE must demonstrate legitimate need based on ownership of or bilateral energy contract with generation inside the CAISO Control Area, and such generation will define the eligible sources the OCALSE may nominate for Long Term CRR allocation.⁴⁵ An OCALSE also will have to pre-pay access charges to be allocated a Long Term CRR.⁴⁶

Several commenters who serve load outside the CAISO Control Area object to the Long Term CRR proposal on grounds that it unduly discriminates against these OCALSEs.⁴⁷ Parties object to the requirements to prepay the Wheeling Access Charge and the legitimate need showing to be allocated Long Term CRRs.⁴⁸ In addition, certain parties object to the allocation of full funding charges to exports via Measured Demand, due to the alleged lack of parity

⁴² See MRTU Tariff at §§ 36.9.1 and 36.9.2.

⁴³ See September 21 Order at PP 744-769.

⁴⁴ Transmittal Letter to January Filing at p. 16.

⁴⁵ See MRTU Tariff § 36.9 and § 36.9.1. The CAISO notes that by adding provisions regarding "Monthly CRRs", "Seasonal CRRs" and "Long Term CRRs" its January 29, 2007 Filing (*see* proposed tariff § 36.2.5, § 36.2.6, and § 36.2.7 respectively), the generic term "CRR" encompasses Long Term CRRs. Therefore, the provisions in MRTU Tariff § 36.9 and § 36.9.1 apply to OCALSE entities seeking to be allocated Long Term CRRs.

⁴⁶ See proposed tariff § 36.9.2.1.

⁴⁷ CMUA at 7-11; IID at 5-7; Modesto at 6-9; SMUD at 4-8,10-16; and TANC at 8-10.

⁴⁸ IID at 10-11; Modesto at 8-9; SMUD at 10-12, 13-15; and TANC at 9-10.

between in control area loads and OCALSEs.⁴⁹ Objections to the requirements on OCALSEs were raised and resolved in the September 21 Order.⁵⁰ The Commission determined that the pre-payment of access charges in order for OCALSEs to receive an allocation of CRRs was just and reasonable and not unduly discriminatory.⁵¹ Similarly, the Commission determined that the legitimate need showing for OCALSEs was appropriate.⁵² For example, the Commission stated that:

We find that the CAISO's proposal provides external LSEs with an opportunity to make a demonstration of legitimate need and affords them the opportunity, upon successful demonstration of legitimate need, to participate in the CRR allocation process as if they were LSEs serving internal load.⁵³

The CAISO's proposal allows all OCALSEs to nominate and be allocated Long Term CRRs and the requirements apply to all OCALSEs on a nondiscriminatory basis. While almost all of the protests cast their arguments in terms of the proposal favoring internal LSEs at the expense of OCALSEs, the reality is that protesting parties are unhappy with a rule that applies to all OCALSEs on a nondiscriminatory basis, *i.e.*, that to demonstrate legitimate need an OCALSE must demonstrate ownership of or bilateral energy contract with generation inside CAISO Control Area.⁵⁴ The rule means that entities who engage in wheel through transactions cannot

⁴⁹ Modesto at 9; IID at 11-12.

⁵⁰ See September 21 Order at PP 766-769.

⁵¹ September 21 Order at P 766 (stating that the CAISO "may impose this pre-payment requirement because external load is situated differently than internal load with respect to its ongoing reliance on the CAISO grid"). The requirement for pre-payment of Access Charges for external Load to receive an allocation of Long Term CRRs is consistent with prior Commission orders where the Commission found that historical support for the embedded costs of the grid does not justify allocation of financial congestion rights, rather that entities must pay the embedded costs of the transmission system on a prospective and long-term basis to receive an allocation of financial congestion rights. *New England Power Pool, et al.*, 100 FERC ¶ 61,287 at P 85 (2002). The Commission found the CAISO proposal to be consistent with the treatment of external load in other energy markets. September 21 Order at P 769.

⁵² *Id.* at P 767.

⁵³ *Id.* at P 768.

⁵⁴ CMUA at 7-8; IID at 6; Modesto at 7; SMUD at 8; TANC at 9-10.

be allocated Long Term CRRs. The Commission explicitly approved of this requirement in the September 21 Order.⁵⁵

The only provision that the Commission has not previously approved is an amendment to account for the pre-payment of access charges over the longer term of the new Long Term CRRs. Recognizing that the payment of access charges for the entire term of a Long Term CRR would be unduly burdensome, the CAISO proposed that an OCLASE must execute a contract with the CAISO committing the entity to make annual access charge payments for each year of the term of a Long Term CRR.⁵⁶ The prepayment would be due at the time of the annual CRR Allocation process for the coming year.⁵⁷ The proposal lessens the financial burden on OCALSES so that the pre-payment requirement is on par with what the Commission has previously approved for OCALSES under the conditionally approved MRTU Tariff.

Some parties contend that regardless of the Commission's conditional approval of the CRR program in the September 21 Order, the CAISO's Long Term CRR program's treatment of OCALSES cannot survive scrutiny under Order No. 681.⁵⁸ The CAISO disagrees. Despite SMUD's and CMUA's protests, the Commission was quite clear in Order No. 681-A that external loads need not be treated on par with internal loads. In denying SMUD's request for rehearing/clarification of the Final Rule, the Commission clearly stated the following:

We deny SMUD's requested clarification to prohibit a transmission organization from allocating long-term firm transmission rights based on whether a customer is

⁵⁵ *Id.* at P 767 (noting that "external LSEs must demonstrate that they have historically utilized the CAISO transmission grid and that they have existing energy contracts with resources internal to the CAISO"). In addition, in discussing the prepayment requirement, the Commission noted that the CAISO may impose the requirement because "external load is situated differently than internal load with respect to ongoing reliance on the CAISO grid." September 21 Order at P 766.

⁵⁶ *See* proposed tariff §§ 11.2.5.2 and 36.9.2.1.

⁵⁷ *Id.*

⁵⁸ SMUD at 6-8; CMUA at 9.

located in the transmission organization's control area or has agreed to cede control of its transmission facilities to that organization. Indeed, we have found in prior orders that, in allocating firm transmission rights, it is not discriminatory for a transmission organization to impose additional requirements on customers external to the transmission organization's control area (external load) as a precondition to receiving such rights.

Order No. 681-A at P 81.

In response to Modesto's objection to allocating uplifts to exports via Measured Demand, the CAISO continues to believe, after extensive stakeholder discussion, that allocating uplifts to Measured Demand is appropriate. Full funding will be applied to all CRRs, not just to Long Term CRRs, and as a result the beneficiaries of full funding will include some entities who export from the CAISO grid to serve external load as well as parties who do not serve any load at all, in addition to LSEs serving internal load. Thus there is no straightforward method to allocate the uplift just to the beneficiaries of the policy. Allocation of the full-funding uplift – as well as the monthly *surplus* when there are excess revenues in the balancing account – therefore appropriately goes to the whole population of loads, both internal and external, served via the CAISO grid.

Finally, SMUD argues that it will be unable to meet its state-mandated renewable resource requirements under the Long Term CRR program. SMUD presents a sworn statement from one of its employees who argues that, *inter alia*, the Long Term CRR proposal will unfairly punish OCALSEs that contract with renewable resources inside and outside of the CAISO Control Area.⁵⁹ The basic premise of Mr. Schwarz's statement seems to be that a 205 MW renewable resource with a capacity factor of 33 percent may at times actually produce energy

⁵⁹ See SMUD Attachment A at 2, 3, and 5-7; see also Modesto at 7. With regard to SMUD's arguments about renewable resources it must export from *within the CAISO control area*, the CAISO notes that the location of these resources allows SMUD to meet the legitimate need test for OCALSEs and that SMUD is objecting to the prepayment requirement.

well in excess of its capacity factor. Therefore, in order for SMUD to manage its exposure to congestion charges from that resource, it would have to nominate CRRs, and therefore prepay the WAC, for 205 MWs for all hours.

SMUD's argument on this matter reflects a misunderstanding of the nature and use of financial rights such as CRRs. The point of holding CRRs associated with a particular resource is to receive a revenue stream that approximately covers the cost of congestion incurred by using that resource to serve load – *on a total basis over the term of the CRR*, not in every hour. Therefore the LSE does not need to hold CRRs in an amount equal to the peak capacity output of the resource, but only in an amount that is typically closer to the expected capacity factor of the resource, in order to obtain a revenue stream sufficient to manage the variable congestion charges associated with scheduling the resource.

In summary, the Commission should reject the protests that allege the CAISO's Long Term CRR proposal for OCALSEs is unduly discriminatory and/or unreasonable. Rather, the Commission should approve the Long Term CRR proposal for OCALSEs as a reasonable extension of the conditionally-approved MRTU provisions for allocating Seasonal and Monthly CRRs to OCALSEs.

E. Making Long Term CRRs Available to Non-Load Serving Entities Through the Secondary Market is Just and Reasonable

Under the CAISO's proposal, only entities that serve load will be eligible to nominate and be allocated Long Term CRRs. Entities that do not qualify for the allocation but desire Long Term CRRs must acquire them in the secondary market, or manage their congestion exposure through Seasonal and Monthly CRRs, as there is no Long Term CRR auction.

Several non-load serving entities protest the CAISO's decision to allocate Long Term CRRs only to entities that serve load.⁶⁰ The CAISO continues to believe that limiting the direct allocation of Long Term CRRs to load serving entities is consistent with the Final Rule. The Commission stated in Order No. 681-A that:

[O]nce load serving entities have received their allocated long-term firm transmission rights, those rights and any additional long-term firm transmission rights available from existing system capacity can be offered to such non-load serving entities (as well as other load serving entities) through a secondary auction, bilateral trades or another method of allocation.⁶¹

Under the CAISO's proposal, non-load serving entities are not in any way precluded or hindered from holding Long Term CRRs in the form of bilateral arrangements external to the CAISO, either with LSEs who have obtained Long Term CRRs or with third parties who wish to offer financial instruments that are equivalent to Long Term CRRs.

F. The CAISO Fully Plans on Complying with Order No. 890 and is Continuing to Improve Its Transmission Planning Processes.

The Commission requires that each transmission organization implement transmission system planning and expansion procedures to ensure that allocated long-term firm transmission rights remain feasible over their entire term.⁶² Several entities protest the CAISO's lack of detail in its transmission planning section of its Long Term CRR proposal and request that the CAISO file its transmission planning process with the Commission.⁶³ Still others complain that the

⁶⁰ WPTF at 4; DC Energy at 5, 7-9.

⁶¹ Order No. 681-A at P 27.

⁶² See Order No. 681 at P 23 and P 453.

⁶³ NCPA at 17-19; TANC at 11-12; Santa Clara at 7-8; CMUA at 14.

CAISO's proposal does not satisfy the planning requirements of the Commission's recent final rule on open access reform, Order No. 890.⁶⁴

As a preliminary matter, the CAISO understands the critical role of transmission planning in ensuring the long-term sufficiency and efficiency of electricity supply in California, as well as the long-term reliability of the Western power grid. Accordingly, the CAISO is working diligently to improve its transmission planning process and improve the transparency of that process. The CAISO plans on fully complying with Order No. 890 in the timeframe prescribed therein.

G. The CAISO's Decision to Allocate Long Term CRRs as Obligation Instruments is Just and Reasonable.

Long Term CRRs under the CAISO's proposal will be created and allocated as obligation instruments, not option instruments.⁶⁵ Several commenters object to the CAISO's refusal to issue Long Term CRR options. They argue that obligation Long Term CRRs cannot satisfy the Final Rule because they are not equivalent to physical rights and that they are otherwise too speculative, especially for intermittent resources.⁶⁶ The CAISO continues to believe that releasing Long Term CRRs as obligation instruments is the appropriate and prudent approach for several reasons. First, as discussed earlier in this answer, the process for allocation of Long Term CRRs was carefully and deliberately integrated into the allocation process for Seasonal CRRs in order to accommodate the diverse preferences of LSEs to obtain their preferred mix of Long Term and Seasonal CRRs without creating a bias towards one or the other. For this reason,

⁶⁴ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 118 FERC ¶ 61,119 (2007).

⁶⁵ CRR obligations entitle the holder to payments if the difference in congestion components between the CRR sink and source is positive, but require payments if the difference is negative. CRR obligations require no such payment if the difference is negative.

⁶⁶ NCPA at 10-11. *See also* SMUD at 17-18; CMUA at 20.

Long Term CRRs cannot be a fundamentally different instrument than Seasonal CRRs. Second, concerns about the risks associated with holding Long Term CRR obligations have been greatly exaggerated with respect to parties who actually need these instruments in association with supply resources they use to serve their load. There is no risk to holding a CRR Obligation when a party has a day-ahead schedule that matches the CRR Source, CRR Sink and MW quantity.⁶⁷ Such schedules can even vary in MW quantity from hour to hour, but as long as the average MW schedule is close to the CRR MW quantity over the term of the CRR the risk is relatively small. Third, compared to a CRR Obligation, a CRR Option is a higher-value instrument and should not be allocated on the same basis as CRR Obligations.⁶⁸ Therefore, although the CAISO intends to consider offering CRR Options in the future, CRR Options should be offered only when there is a mechanism such as an auction process whereby the recipients of CRR Options pay an appropriate market price for them. Under the current CRR formulation this would be inappropriate and premature.

H. The CAISO Will Continue to Evaluate the Future Possibility of Conducting an Auction for Long Term CRRs.

Under the CAISO's proposal, Long Term CRRs will be directly allocated to entities that serve load, without cost. As filed, the Long Term CRR proposal does not contain a Long Term

⁶⁷ See Dr. Pope's testimony, Exh. No. ISO-2 at pp. 20 and 73 (explaining that a CRR obligation can provide a perfect congestion hedge even in the circumstance in which the CRR Holder is required to make a payment because the transaction hedged by the CRR would receive an offsetting congestion payment for providing counterflow so that the net congestion charge to the holder would still be zero).

⁶⁸ See also Dr. Pope's testimony, Exh. No. ISO-2 at p. 72.

CRR auction. Many commenters noted the lack of an auction for Long Term CRRs and request the Commission to order the CAISO to include an auction of Long Term CRRs.⁶⁹

Although the CAISO is not proposing an auction for Long Term CRRs, it is possible under the CAISO's proposal for holders of Long Term CRRs to sell one-year seasonal portions of their Long Term CRRs in the annual auction processes, or sell monthly portions of their Long Term CRRs in the monthly auctions. While the CAISO has not ruled out the possibility of conducting an auction for Long Term CRRs at a later date, the CAISO has diligently reviewed this possibility and found that it would not be possible to implement by the time the first Long Term CRR allocation is scheduled to take place. Moreover, the suggestion was raised by certain stakeholders late in the process of developing the CAISO's compliance filing and would have required an extensive reconsideration through the stakeholder process of the design of the overall Long Term CRR release process, which could not be accommodated by the due date for the compliance filing. In recognition of the interest in such an auction expressed by some stakeholders, however, the CAISO has added a Long Term CRR auction to its list of candidate CRR enhancements that it will discuss further with stakeholders and consider making after the start up of the MRTU market.⁷⁰ Because the Final Rule does not require a Long Term CRR auction, the CAISO continues to believe that its Long Term CRR program satisfies the Final Rule, and is otherwise just and reasonable, without an auction.

I. The CAISO's Proposal To Grant Expiring ETCs Access to the Priority Nomination Process is Just and Reasonable.

⁶⁹ PG&E at 8-9; DC Energy at 10; WPTF at 5.

⁷⁰ See Dr. Pope's testimony, Exh. No. ISO-2 at p. 71 (noting that the design of Long Term CRRs will facilitate the addition of an auction if and when the CAISO and its stakeholders decide to add an auction for Long Term CRRs).

Under the Long Term CRR proposal, the CAISO proposed a change to the MRTU CRR program that will accommodate those parties that hold Existing Transmission Contracts (“ETCs”) that may expire during the 10-year term of the original Long Term CRRs. Through a process analogous to that proposed for Converted Rights (“CVR”) in the filed and conditionally-accepted MRTU Tariff, the CAISO will allow these expiring ETCs to be nominated in the Priority Nomination Process of the annual allocation of Seasonal CRRs for the year that follows the expiration of the ETCs.⁷¹ This will enable the expiring ETC holder to be allocated Seasonal CRRs for the path of the expiring ETC to the extent it is within the LSE’s eligible quantity as determined by its non-ETC load and simultaneously feasible with the other PNP nominations (which would be the expected outcome because the ETCs will have been modeled by the CAISO in previous years’ SFTs before their expiration).

MWD expresses appreciation for this change.⁷² State Water Project, however, asks for a different treatment of expiring ETCs. SWP argues that LSEs whose ETCs expire after others’ Long Term CRRs are locked in through the 2008 allocation should, upon contract expiration, be directly allocated the Long Term CRRs the CAISO modeled in the SFT to ensure the “perfect hedge” for their contract rights. Thus, rather than be granted access to the PNP for expiring ETCs on a basis comparable to other LSEs, which the CAISO proposes, SWP asks that a hybrid Seasonal-Long Term CRR be created for the remainder of the term of the originally allocated Long Term CRRs, essentially extending the expiring ETC for the full term of the Long Term CRRs that were allocated prior to the start of the MRTU markets. Thus, one major difference between the CAISO’s proposal and SWP’s approach is that SWP asks that expiring ETCs be

⁷¹ See Dr. Kristov’s discussion of ETCs, Exh. No. ISO-1 at pp. 40-43; and proposed tariff § 36.8.3.5.1.

⁷² MWD at 5.

converted automatically into a right that would not be subject to annual SFTs through the PNP and the possibility, however small, that the Seasonal CRR nominated in the PNP might not be awarded. Another major difference is that SWP seems to ignore the principle that CRRs are allocated to LSEs based on Adjusted Load Metrics and Eligible Quantities determined from their load that is not covered by ETCs. If the CAISO were to allocate CRRs to SWP based on the MW quantity of their expiring ETC rights the amount would substantially exceed their eligible quantities and thus award them a substantial benefit over other LSEs.

The CAISO believes that its proposal to allow PNP treatment for expiring ETCs is a just and reasonable accommodation of ETCs that will expire after the original allocation of Long Term CRRs has occurred. SWP's proposal is inappropriate because it would essentially give the expiring ETC holder a substantial advantage over other LSEs, rather than place the expiring ETC holder on a comparable basis with other LSEs as the expiration of the ETC should do.

Moreover, such a policy as SWP proposes would, if taken literally, assign Long Term CRRs to each expiring ETC holder regardless of whether or not the entity really wants them.

Alternatively if the CAISO were to give expiring ETC holders the option to extend their expiring ETCs with complete certainty, this approach would raise the same issues described above in response to PG&E's argument for guaranteed renewal of expiring Long Term CRRs, *i.e.*, the need to model the option to renew in the post-expiration SFTs and the associated complications.

In summary, while the CAISO recognizes that expiring ETC holders, like LSEs holding expiring Long Term CRRs, face some uncertainty in trying to obtain the full amount of the specific Long Term CRRs that correspond to their expiring rights, a guarantee of renewal would impose unreasonable costs on the rest of the market, either in the form of smaller released quantities of Long Term CRRs or greater risk of revenue shortfall.

J. The CAISO's Treatment of Load Migration is Just and Reasonable.

The Long Term CRR program complies with Guideline No. 6 of the Final Rule⁷³ by extending the rules for Seasonal and Monthly CRRs under the conditionally-accepted MRTU Tariff to Long Term CRRs. The conditionally-approved rules require CRRs to follow the load in the case of load migration. Section 36.8.5.1.1 of the filed MRTU Tariff, as revised November 20, 2006, requires a load serving entity that loses load through direct access load migration during the annual CRR allocation cycle to transfer a portion of its allocated seasonal CRRs for the remainder of the annual cycle, or the financial equivalent, to the load serving entity that gained the load. The CAISO proposes to apply the same requirement to allocated Long Term CRRs, with two modifications.⁷⁴

PG&E argues that the CAISO's proposal should be modified so that Long Term CRRs that are reassigned as a result of load migration correspond to the Long Term CRRs actually used by the migrating load, rather than merely a *pro rata* reassignment of an LSE's Long Term CRRs. Unlike with CRRs that have only a one-year term, Long Term CRRs with 10-year terms require a reassignment process that considers the location and source of the migration.⁷⁵ AReM argues that LSEs gaining load through load migration should be placed on the same footing in the PNP as expiring ETCs.⁷⁶

⁷³ Guideline No. 6 states that "A LTTR held by a load serving entity to support a service obligation should be re-assignable to another entity that acquires that service obligation." *See, e.g.*, Order No. 681-A at P 15.

⁷⁴ First, the option to transfer the financial equivalent of Long Term CRRs rather than the CRRs themselves will be limited to the calendar year in which the load transfers, or to the next calendar year if the annual CRR allocation process for that year's Seasonal CRRs has already been completed. Second, the CAISO has decided to play a more active role in tracking load migration for the purposes of the CRR program. *See generally* Transmittal Letter to the January Filing at pp 21-22.

⁷⁵ PG&E at 7-8.

⁷⁶ AReM at 6-7.

PG&E's suggestion is partially based on an incorrect assumption and is partially valid but not readily resolvable. The incorrect assumption is that certain supply resources and associated CRR sources can be associated with specific loads. There simply is no objective way to make such an association. The valid point is that the load-losing LSE generally does not transfer pro rata portions of its supply portfolio when load migrates, a fact which at first glance appears incongruous with the requirement to transfer a pro rata share of its allocated CRRs. This is clearly true for LSEs that own generation – they will continue to own and utilize those resources after the migrating load begins being served by another LSE. This observation misses the point of the CRR transfer, however. The point is not to transfer only a pro rata share of CRR MW to the new LSE, but to transfer a pro rata share of CRR *value* to the new LSE. If the load-losing LSE were allowed to select specific CRRs from its allocated portfolio to transfer, there would need to be some mechanism to ensure that the load-gaining LSE actually received the appropriate share of the value of the first LSE's allocated CRR holdings. In the case of Seasonal CRRs, and for the first year of Long Term CRRs, reliable estimates of the value of the required CRR transfer can be derived from the auction prices from the most recent annual CRR Auction. This is why the CAISO proposal allows financial payments to substitute for actual CRR transfers in the case of Seasonal CRRs and the first year of Long Term CRRs. But for the subsequent years of Long Term CRRs there are no estimates of value that could support financial payments, and therefore the CAISO proposed to require the actual transfer of the Long Term CRRs.

For the same reason, the CAISO believes that allowing a load-losing LSE to select which Long Term CRRs it wishes to transfer is not appropriate. From the earliest discussions of CRR allocation in the development of the MRTU design, the CAISO has emphasized that CRRs are the property of the load itself, and are allocated to LSEs only as custodians of these financial

instruments for the load they serve. When load migrates from one LSE to another LSE, its share of the value of the allocated CRR portfolio should transfer with it. That is the fundamental principle underlying the CAISO's proposed requirement to transfer pro rata shares of allocated Long Term CRRs, for which the CAISO does not see a workable alternative at this time.

With regard to AReM's proposal (*i.e.*, that LSEs gaining load through load migration should be placed on the same footing in the PNP as expiring ETCs), this is really an issue affecting all CRRs, not just Long Term CRRs, and the CAISO has appropriately included it in its current stakeholder process on CRR issues. At this time the CAISO is positively disposed toward this proposal, but must allow for thorough vetting with all stakeholders before formally proposing its adoption. Any rule change regarding AReM's proposal will be included in the CAISO's May 2, 2007 filing.

K. Capping Long Term CRR Eligibility at 50 percent of Adjusted Load Metric is a Just and Reasonable Limitation on Long Term CRR Eligibility.

The CAISO proposes to limit Long Term CRR nominations to 50 percent of a load serving entity's Adjusted Load Metric.⁷⁷ The Adjusted Load Metric consists of the load serving entity's Load Metric⁷⁸ minus any MWs of Load covered by Existing Transmission Contracts, Converted Rights, and Transmission Ownership Rights. AReM generally supports the idea of a 50 percent load cap Long Term CRR eligibility but raises a concern that holders of ETCs, TORs, and CVRs will be over-allocated Long Term CRRs under this program.⁷⁹ The crux of AReM's protest on this issue is that ETCs, TORs and CVRs are effectively long-term rights already. This

⁷⁷ See proposed tariff § 36.8.3.1.3 (CRR Year One) and proposed § 36.8.3.5.2 (beyond CRR Year One).

⁷⁸ The Load Metric is the basis of a load serving entity's load eligible for CRR allocation and is calculated as the level of Load in megawatts (MW) for a defined time period that is exceeded in only 0.5% of the hours of that time period based on historical or forecast Load data.

⁷⁹ AReM at 8-10.

means, according to AReM, that allocating Long Term CRRs to holders of ETCs, TORs, and CVRs for up to 50 percent of their Adjusted Load Metric carries the possibility that those entities will receive long-term rights (*i.e.*, Long Term CRRs plus ETCs, TORs, CVRs) for more than half their load. AReM suggests a 50 percent cap on total load.

The suggestion to subtract ETC and CVR from an LSE's eligibility for Long Term CRRs was put forward by a stakeholder and duly considered by the CAISO.⁸⁰ While the rule seemed reasonable in concept, the CAISO found that the rule would have relatively little impact for two reasons. First, the vast majority of ETCs and all CVRs do not provide ten years of coverage comparable to Long Term CRRs and therefore do not meet Guideline 4 of the Final Rule. Second, in those instances where there is ETC coverage for 10 years, so large a percentage of the right holders' Adjusted Load Metric is fully covered by the ETC rights⁸¹ that the ETC holder has almost no eligibility for either Seasonal CRRs or Long Term CRRs.⁸² Consequently, the CAISO did not propose to reduce LSEs' eligibility for Long Term CRRs by the amount of their ETC coverage.

L. Miscellaneous Issues.

1. Schedule for Unresolved Issues.

SCE requests that FERC establish specific dates by which the CAISO must address certain unresolved Long Term CRR issues noted in the CAISO's filing, including trading hub issues, allocation of rights for transmission upgrades, and transmission planning.⁸³ The CAISO agrees that resolution of these issues is important to implementation of Long Term CRRs and is

⁸⁰ See Dr. Kristov's discussion of this issue at Exh. No. ISO-1 at pp. 40-43.

⁸¹ *Id.*

⁸² *Id.* at 42.

⁸³ SCE at 7-9.

actively working with its stakeholders to do so. The timeline that the CAISO and its stakeholders are adhering to is included as **Attachment A** to this filing letter.

2. Proposed Changes to Allocation Structure.

As described in detail in the Long Term CRR Transmittal Letter, the CAISO will create a nomination process for Long Term CRRs called Tier LT that will follow Tier 1 and 2 in the CRR allocation process for CRR Year One, and after Tier 1 (*i.e.*, after the Priority Nomination Process) in the CRR allocation process for years subsequent to CRR Year One. Six Cities advocate changing the Long Term CRR allocation process so that Tier LT does not follow the Priority Nomination Process but instead follows Tier 3 of the annual CRR Allocation.⁸⁴ Six Cities argue that this change would enhance the Long Term CRR program because LSEs would have more information about their allocations before making Long Term CRR nominations, and it would put the Long Term CRR simultaneous feasibility test process at the end of the allocation and enable the CAISO to allocate Seasonal CRRs more expeditiously.

Stakeholders generally accepted the placement of Tier LT. The issue raised by SixCities was not raised during the stakeholder process and the CAISO has not had an opportunity to fully vet its implications with other stakeholders. Under the CAISO's filing, the Long Term CRR nominations must come from the results of the verified tiers in Year 1 or the results of the PNP in Year 2 and beyond. While SixCities could be correct that entities might want to have more information prior to making Long Term CRR nominations, it could also be true that many entities may want to know their Long Term CRRs before making their Tier 3 nominations. At this point in the process, it would be difficult to entertain SixCities proposal by reopening one of

⁸⁴ Six Cities at 8.

the settled aspects of the Long Term CRR design. However, the CAISO will consider adding the proposal to the list of possible CRR enhancements that it will discuss further with stakeholders.

3. Testing and Request for Additional Dry Run.

As part of the Long Term CRR process, the CAISO has been discussing with its stakeholders the possibility of using a “multi-period” constraint that will, when applied to the running of multiple sets of SFTs simultaneously, allocate constant-MW 10-year Long Term CRRs in an optimal manner.⁸⁵ Six Cities urge the Commission to require the CAISO to undertake significant testing of the Long Term CRR multi-period algorithm before implementing it.⁸⁶ The CAISO fully intends to test this algorithm before deploying it for CRR Year Two. Because this feature requires software that will not be available, nor needed, until CRR Year Two, it should not stand in the way of approval and successful launch of the Long Term CRR program.

Six Cities also requests an additional Dry Run to evaluate the Long Term CRR process.⁸⁷ The CAISO disagrees that another CRR Dry Run is necessary for the implementation of Long Term CRRs. This was one of the primary drivers of incorporating the Long Term CRR design into the conditionally-accepted CRR design under MRTU. The Long Term CRR proposal does not substantially alter CRR process as tested through the CRR Dry Run. The CRR Dry Run tested the full tiered allocation approach and already provided participants ample opportunity to explore the intricacies of the CRR design. The addition of the Tier LT does not add any significant complexity for participants. Also, as previously discussed, the initial results from the

⁸⁵ See Dr. Kristov’s discussion of this issue at Exh. ISO-1 at p. 45.

⁸⁶ Six Cities at 10.

⁸⁷ Six Cities at 10.

CRR Dry Run aided and influenced the design of the Long Term CRR program. There is no guarantee that conducting another dry run would yield any significant benefits and to engage in another dry run would unnecessarily delay the CAISO's efforts towards implementing MRTU.

4. Scheduling Priority.

Santa Clara argues that the CAISO should provide a scheduling priority for Long Term CRRs.⁸⁸ As a preliminary matter, the CAISO wishes to emphasize that the concept of a scheduling priority for CRRs is inconsistent with the CRR design in general. CRRs have no direct relationship to physical scheduling, and in fact are not required to be matched by a physical schedule for their holders to be entitled to the revenue stream associated with the properties of the Long Term CRR. In addition, the CAISO notes that the Commission fully considered and rejected this precise issue raised by Santa Clara on rehearing of Order. No. 681 and should not revisit here.⁸⁹

5. Risks for Small Loads.

NCPA asserts that the risks associated for Long Term CRRs are much greater for smaller entities like NCPA as compared to PG&E and SCE. NCPA states that:

Because of the sheer size of their loads and generation resources, PG&E and SCE will be eligible to hold large portfolios of LTCRRs (along with seasonal and monthly CRRs), which will allow them to more completely diversify their holdings across the grid. This in turn will give them much better odds that the instruments will produce an average positive value to cover the losses associated with those instruments that "go negative" in value.⁹⁰

NCPA claims that the disproportionate risk on small LSEs vitiates the ability to use the Long Term CRRs to hedge existing resources and plan new ones, and thus fails to meet the clearly

⁸⁸ Santa Clara at 8-9.

⁸⁹ Order No. 681-A at PP 100-01.

⁹⁰ NCPA at 12.

articulated goal of the statute.⁹¹ NCPA also alleges that small entities are disproportionately affected by the “relative lack of data on LMP prices and CRR values.”⁹² NCPA states that only limited studies have been done based on the recent results of the CRR Dry Run to determine the value and availability of CRRs.⁹³ Without more extensive data, NCPA states it will be very difficult and speculative for LSEs to estimate the potential risk associated with obligations Long Term CRRs, let alone assess whether Long Term CRRs might provide a sufficient hedge.⁹⁴ NCPA notes that it does not have access to CAISO’s input data essential for NCPA to perform its own LMP and CRR studies because it has declined to sign a CAISO non-disclosure agreement. The relief requested by NCPA is that the Commission act on NCPA’s pending motion seeking modification of the CAISO nondisclosure agreement.⁹⁵

Contrary to NCPA’s implication, the statute, the Commission’s Final Rule, and the CAISO’s compliance filing in response to the Commission’s Final Rule apply to all LSEs on a non-discriminatory basis. Furthermore, the CAISO is not convinced that any of the risks mentioned by NCPA are, on a percentage basis, less for large LSEs as compared to smaller LSEs. Regarding instruments that NCPA asserts “go negative,” the CAISO explained previously that there is no risk to holding a CRR Obligation when a party has a day-ahead schedule that matches the CRR source, sink and MW quantity.⁹⁶

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 13.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *See* Section III.G. of this pleading. The CAISO also notes that CRR obligation can provide a perfect congestion hedge even in the circumstance in which the CRR Holder is required to make a payment because the transaction hedged by the CRR would receive an offsetting congestion payment for providing counterflow so that the net congestion charge to the holder would still be zero. *See* Dr. Pope’s testimony, Exh. No. ISO-2 at pp. 20 and 73.

Regarding NCPA's remarks about the CRR Dry Run process and the LMP studies, while the CAISO disagrees with NCPA's characterization of the process, the relief requested by NCPA is that the Commission act on its pending motion to modify the CAISO's non-disclosure agreement.⁹⁷ NCPA raised the issue in its December 22, 2006 pleading in Docket No. ER06-615 and the CAISO responded fully to NCPA's arguments in its January 16, 2007 answer.⁹⁸ There is no reason to delay or reject the CAISO's January Filing in this proceeding on the basis of NCPA's arguments.

6. Credit and Collateral.

Both CMUA and NCPA ask the Commission to require the CAISO to file with the Commission all credit and collateral requirements for Long Term CRRs because the longer term of Long Term CRRs could place significant collateral requirements on small LSEs.⁹⁹ The CAISO notes that, in Order No. 890, the Commission has placed new explicit requirements on transmission providers regarding the level of detail to be contained in the tariff with regard to credit and collateral.¹⁰⁰ Moreover, the CAISO has pending in Docket No. ER06-700 a compliance filing that proposes to include certain details of the CAISO's credit policy in the tariff while maintaining the balance of the details making up the CAISO's credit policy in its Credit Policy & Procedure Guide. The CAISO's compliance filing was drafted in an effort to be consistent with the proposal in the Notice of Proposed Rulemaking and which is now subsumed within Order No. 890. The CAISO anticipates that the Commission's order on its compliance

⁹⁷ NCPA at 13.

⁹⁸ See January 16, 2007 Answer of CAISO in Docket No. ER06-615 at p. 15-17.

⁹⁹ NCPA at 14-15; CMUA at 19; DC Energy at 11.

¹⁰⁰ See Order No. 890 at PP 1656-57 (requiring transmission providers to file a new attachment to their open access tariffs containing their credit and collateral requirements).

filing in Docket No. ER06-700 will provide additional guidance concerning which details are required to be in the CAISO Tariff. Finally, as stated earlier, the CAISO fully plans on complying with Order No. 890 and views that proceeding as the most expeditious manner to resolve issues about tariff detail on credit and collateral.

IV. CONCLUSION.

Wherefore, the CAISO respectfully requests that the Commission accept the CAISO's compliance filing as proposed and as discussed herein, without suspension or hearing, to go into effect on July 1, 2007 as requested.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned docket.

Dated at Folsom, California on this 12th day of March, 2007.

/s/ Anna A. McKenna

ATTACHMENT A

2007 FERC Filings to Address Remaining CRR Related Issues

Activity	Expected Filing Date	Comments
1. CRR Dry Run Report	March 30	Intended to be filed after the completion of the dry run.
2. Potential Changes to CRR Rules		
a. CRR Source Nominations at Trading Hubs in the CRR Allocation Processes	May 2	Will be part of the rules on which the CRR allocation will be based. Must be approved prior to the allocation.
b. Set-aside of Import Capacity on Inter-ties for CRR Auction	May 2	The set-aside rules must be determined prior to the CRR allocation.
c. CRR Source Verification Historical Period and Rules	April 19	Change in the historical period in the tariff must be approved prior to the CRR Allocation.
d. Modeling of Transmission Outages in the CRR Network Model for Release of Monthly CRRs	August 3	Should be filed no later than 180 days prior to the start of MRTU.
e. Use of Common Forecasts for Monthly CRR Eligibility and Monthly RA Showings	August 3	Should be filed no later than 180 days prior to the start of MRTU.
F. Frequency of Monthly Allocation and Auction Process	August 3	Should be filed no later than 180 days prior to the start of MRTU.
2. Outstanding CRR Process Issues		
a. CRR Transfers due to Load Migration	August 3	Should be filed no later than 180 days prior to the start of MRTU.
b. Methodology for Determining CRRs for Merchant Transmission Upgrades	May 2	Methodology must be in place by first allocation of long term CRRs, which will occur within the CRR Year One allocation process.

c. CRR Credit Requirements	May 2	This must be filed in time to receive approval for the methodology before performing creditworthiness check prior to the first CRR auction.
3. Filing to FERC on Implementation Features		
a. Template for TRTC Instructions	March 9	Template was filed in March in anticipation of FERC approval in time for affected parties to complete and return to the CAISO prior to first CRR auction/allocation. This information will be used for market simulation purposes as well as modeling ETC, TOR, CVR for CRR auction/allocation.
b. Information Provision, Collection and Verification	March 9	CAISO seeking authority to conduct certain activity in preparation for the CRR allocation and auction.
c. Candidate CRR Registration and CRR Entity Agreement	March 9	Registration details and pro-forma agreement will be filed as FERC approval is needed in time for stakeholders to complete for participation in auction/allocation.
4. CRR Business Practice Manual	May 2	Filing with FERC in accordance with the time schedule set for BPMs.