



California Independent
System Operator Corporation

May 16, 2007

The Honorable Kimberly D. Bose
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

**Re: California Independent System Operator Corporation
Docket No. ER06-615-003**

Dear Secretary Bose:

Enclosed for filing in the above-referenced docket is the California Independent System Operator Corporation's Response to Comments on the Congestion Revenue Rights Dry Run Report.

Thank you for your assistance in this matter.

Respectfully submitted,

/s/ Anna A. McKenna
Anna A. McKenna

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III. RESPONSE TO COMMENTS

A. Comments of PG&E

PG&E notes that the CRR Dry Run revealed that the CRR revenues received by Load-Serving Entities (“LSEs”)² on average, only matched up to 80% of each LSE’s estimated congestion charges through the one-year Seasonal CRR allocation process.³ While not asking that the Commission delay implementation of MRTU, PG&E requests certain Commission actions based on the CRR Dry Run results.⁴ Before responding to PG&E’s comments, the CAISO notes that foundation for many of PG&E’s requests, specifically the observation that CRR revenues LSEs received based on their allocated one-year Seasonal CRRs match roughly 80% of their estimated congestion charges, does not indicate any inadequacy in the CRR Dry Run allocation. Under the structure of the CAISO’s filed and conditionally-approved CRR allocation process, the annual allocation process for one-year Seasonal CRRs should only be expected to cover seventy-five percent (75%) of LSEs’ congestion exposure.⁵ The monthly allocation process is designed to provide additional CRRs corresponding to the remaining 25% of each LSE’s congestion exposure.

PG&E asks the Commission to order that the CRR allocation and auction rules will be subject to review and revision after the MRTU is implemented and a track record of participant behavior is established.⁶ The CAISO continuously monitors and evaluates and reviews the performance of its markets and intends to do the same with the performance of CRR allocation

² For the purposes of this pleading, the term “LSE” will be used generically to mean any load serving entity. Under the MRTU Tariff, the term LSE refers specifically to load within the CAISO Control Area.

³ PG&E at 1.

⁴ PG&E at 2-3.

⁵ *See* Dry Run Report at 3.

⁶ PG&E at 2.

and auction rules. The results of the CRR Dry Run do not give rise to the need for the creation of specific review and revision mechanisms for CRRs that would not be captured through the CAISO and its stakeholders' observations of CRR holdings and transfers. All market participants and observers of the CAISO market will have access to information on CRR holdings through the public postings contemplated under Section 6.5.1.3 of the MRTU Tariff as conditionally accepted, which will allow any party to observe the outcome of the CRR Allocation and Auction rules over time. Any party has the right to raise any concern with the CAISO and/or the Commission at any time based on such information without having to establish additional monitoring requirements.

PG&E recommends that the Commission require that more capacity be made available for the auction process "allowing participants to supplement their allocations as needed and, in essence, freeing them from total reliance on the strict allocation rules and possible design limitations of the allocation process."⁷ The CAISO has addressed this concern, which also was articulated by other parties in its most recent stakeholder process, in its May 7 filing in Docket No. ER07-869, *et al.* ("May 7 Filing"). As explained in the testimony of Dr. Lorenzo Kristov in Exhibit No. ISO-1 attached to the May 7 Filing, there were two tensions between competing preferences of market participants that had to be balanced in developing the CAISO's CRR proposal.⁸ The first tension was the balance between flexibility and certainty. The second tension was the balance between primary reliance on direct allocation of CRRs to LSEs versus

⁷ PG&E at 3. PG&E also requests that renewal of Long Term CRRs be guaranteed. *Id.*

⁸ *See* May 7 Filing, Exhibit No. ISO-1, Testimony of Dr. Kristov at 45-47.

greater reliance on an auction process whereby CRRs are made available to all participants and are valued at market-clearing prices.⁹

As demonstrated by PG&E's comments, these two tensions are somewhat interrelated and each stakeholder has its own preferences regarding the optimal balance points. While PG&E requests a greater use of auctions for the sake of greater flexibility, it also requests that the renewal of Long Term CRRs be guaranteed for the sake of greater certainty.¹⁰ While the CAISO appreciates the reasons underlying PG&E's comments, as the CAISO articulated more fully in its May 7 Filing, the balance the CAISO has struck between the use of allocations and auctions in its CRR proposal is a reasonable one and one that reflects an appropriate balance of competing stakeholder interests.

B. Comments of Powerex

All of Powerex's comments involve the CAISO's proposal to set aside a certain amount of intertie transmission capacity for import CRRs in the annual and monthly CRR auctions.¹¹ Powerex says that the results of the CRR Dry Run auction suggest that a low level of intertie CRRs will clear in the auction (as compared to the allocation of CRRs) and will undermine the

⁹ *Id.*

¹⁰ *See* PG&E at 3 for both comments. Regarding PG&E's request for guaranteed renewal of Long Term CRRs, the CAISO respectfully points out that this matter has no relevance to or basis in the CRR Dry Run, as the Dry Run was designed and completed prior to the CAISO's filing on Long Term CRRs and did not in any way address that element of the CRR allocation design. The CAISO responded to comments asking for guaranteed renewal of Long Term CRRs in Docket No. ER07-475-000.

¹¹ *See* MRTU Tariff § 36.8.4. The capacity set aside for import CRRs was contained in the MRTU tariff language filed on February 9, 2006. The capacity set aside tariff language also was maintained in the CAISO's January 29, 2007 amendments to comply with the Commission's Final Rule regarding long-term firm transmission rights in Docket No. ER07-475-000 ("January Filing"). *See also 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"); and Order No. 681-A, 117 FERC ¶ 61,201 (2006) ("Order No. 681-A"). Finally, the tariff language regarding the capacity set aside for import CRRs was maintained in the CAISO most recent CRR filing. *See* May 7, 2006 filing regarding "Amendments to Facilitate the Initial CRR Allocation and Auction Process under MRTU" and "CRRs for Sponsors of Merchant Transmission Upgrades", Transmittal Letter at 21.

effectiveness of the MRTU Tariff’s auction set-aside provisions.¹² Specifically, Powerex states that: (i) the low level of import CRRs clearing the auction appear to be the result of the CAISO setting aside capacity on the intertie in the form of a source location but without modeling a sink location for the set-aside intertie capacity, and (ii) this result rendered many bids for import CRRs infeasible.¹³ Powerex alleges this aspect of the CRR Dry Run appears to be unjust and unreasonable and contrary to the objective of making a “sufficient level” of import CRRs available in the auction.¹⁴ Powerex claims that the CAISO must modify its auction set-aside procedures to preserve the integrity and purpose of the set-aside.

The phenomenon described by Powerex did occur in some cases; however, in other cases large quantities of both import CRRs and export CRRs cleared the auction. Viewed in their entirety, the CRR Dry Run auction results demonstrate that the quantity of import CRR bids on any particular intertie that clear the auction will depend, in large part, on the quantity of export bids on the same intertie (*i.e.*, CRR that are counterflows for the import CRRs), in addition to the amount of the import capacity set aside for the annual and monthly auctions. In addition, the issue raised by Powerex was addressed in the CAISO’s May 7 Filing (which was filed after Powerex filed its comments on the Dry Run Report).¹⁵ As explained by Dr. Kristov, the CRR Dry Run:

demonstrated that for many interties and many CRR terms (season/TOU and month/TOU): (1) more import capacity was available for auctions than was initially set aside, due to the fact that LSEs often did not nominate as much as they were eligible for in the CRR allocations; (2) on some interties the auction participants did not bid for much of the available capacity; and (3) on other

¹² Powerex at 7.

¹³ *Id.* at 6.

¹⁴ *Id.* at 7.

¹⁵ See May 7 Filing Transmittal Letter at 21; see also May 7 Filing, Exhibit No. ISO-1, Testimony of Dr. Kristov at 66-70.

interties the available capacity attracted significant quantities of bids and significant quantities of CRRs were awarded. There were some instances, however, where parties did bid for available import capacity but very small quantities cleared the auction, mainly due to “downstream” constraints within the CAISO system that caused the import CRRs to be infeasible.¹⁶

The CAISO does not believe that the instances in which small quantities cleared the CRR auctions in the CRR Dry Run require a modification in the CRR rules.¹⁷ If other auction participants bid to obtain export CRRs on these interties it will create counterflows in the CRR optimization and enable more import CRRs to clear.¹⁸ Dr. Kristov also noted that there is an important difference between interpreting the allocation results versus interpreting the auction results when considering the CRR Dry Run. In the Dry Run allocation of CRRs there were strong incentives for LSEs to submit nominations that reflect the patterns of their actual use of the CAISO grid, because LSEs were interested to get an initial assessment of how well the CRR allocation rules could provide an amount of CRRs to manage expected congestion under MRTU.¹⁹ However, with auctions there is no way to say how realistic the entire set of submitted bids for any specific auction market was or how good a picture the auction results provide with regard to the bidding behavior we can expect to see in production.²⁰ The Dry Run auction process demonstrated that the CRR auction systems work and provide a view of one potential scenario of bidding behavior and outcomes.²¹ In sum, the quantities of import CRRs that cleared

¹⁶ May 7 Filing, Exhibit No. ISO-1, Testimony of Dr. Kristov at 67.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ Dr. Kristov explains that the financial analysis of the CRR Dry Run allocation results was conducted explicitly to provide information on how LSEs can manage their expected congestion costs, and the source verification was conducted to provide some realism to the sets of eligible sources LSEs could nominate in the verified tiers. *Id.* at 67-68.

²⁰ *Id.* at 68.

²¹ *Id.*

the auction to a large degree were a result of how the participants bid and did not depend entirely on the set-aside quantities for imports of CRRs which were a result of the source verification process in the Dry Run allocation.²² As a result the CAISO does not believe that it is appropriate to modify the rules for the set aside of intertie transmission capacity for import CRRs in the annual and monthly CRR auctions.

Powerex states that the CAISO did not include in the Dry Run Report the impact of the Tier LT and how it may affect the availability of intertie CRRs in the auction in Year 2 and beyond.²³ Therefore, Powerex contends that there is a danger that the quantity and quality of import CRRs will be degraded over time, due to rules that favor LSEs.²⁴ The CAISO does not believe any modifications are required in response to Powerex's comment. The procedures for allocating Long Term CRRs were not part of the CRR Dry Run due to the timing of the Commission's Final Rule on long-term firm transmission rights. The CRR Dry Run was planned (and began) prior to the issuance of the Commission's Final Rule on July 20, 2006 and the CRR Dry Run was almost concluded by January 29, 2007 (the date the CAISO filed its Long-Term CRR proposal in compliance with the Commission's Final Rule). However, as the CAISO noted in its May 7 Filing, the Long Term CRR allocation proposal is based on an extension of the rights obtained through the first two tiers of the one-year Seasonal CRR allocation process conducted for the first year of MRTU and parties may be able to use the results of the CRR Dry Run as an indication of the possible nominations for Long Term CRRs that they could have made based on what they were allocated in those two prior tiers.²⁵

²² *Id.*

²³ Powerex at 8.

²⁴ *Id.*

²⁵ *See* May 7 Filing Transmittal Letter at 5, n.14.

Powerex claims that the CRR Dry Run results could be invalid due to the change in historical reference period used for source verification purposes.²⁶ The CAISO addressed Powerex's concern in the May 7 Filing indicating that: (i) the CAISO does not expect the change of the historical reference year will have a large impact on the set-aside quantities because, in general, the reliance of LSEs on imports has not changed significantly from 2004 to 2006, and (ii) while the CAISO identified potential options to address the issue, none of the options explored with stakeholders was targeted sufficiently such that they would not have broad effects on the fundamental design of the CRR programs that, in turn, would require further extensive discussions with stakeholders.²⁷

C. Comments of NCPA

NCPA states that the CRR Dry Run Report filed with the Commission is stripped of identifying data and concrete participant results and therefore is so general that it is almost impossible for Market Participants to draw reliable conclusions as to the adequacy of overall market congestion coverage or whether the CRRs themselves are likely to be revenue adequate.²⁸ NCPA says that it is not suggesting that individual data be made public, only that the publicly available portion of the report is insufficient for Market Participants to determine whether the overall system will produce adequate results.²⁹ Specifically, NCPA claims that:

[W]hile the CAISO has provided financial analysis to the Commission as to general overall coverage of congestion costs provided by CRR revenues, and analysis of CRR revenue adequacy, NCPA, at least, has not received any of the information pertaining to the financial results of its individual allocations. *Even though NCPA has been able to perform its own financial analysis using its own*

²⁶ See Powerex at 8. The change in the historical reference period for CRR source verification is to use calendar year 2006. See, e.g., May 7 Filing Transmittal Letter at 11.

²⁷ See May 7 Filing, Exhibit No. ISO-1, Testimony of Dr. Kristov at 69-70.

²⁸ NCPA at 1.

²⁹ *Id.* at 2.

*data, the CAISO should provide each participant with their individual financial results to allow each participant to check the validity of its conclusions. Without that data, it is hard for NCPA to comment meaningfully on the Dry Run due to the vague and general nature of the information contained within the report.*³⁰

NCPA requests that the Commission direct CAISO to provide each Market Participant with its individual financial results in order to allow each individual participant to assess the effectiveness of its acquired CRR hedge against CAISO's assessment of its anticipated congestion costs.³¹

The Commission need not order that the CAISO "provide each Market Participant with its individual financial results" because the CAISO has offered to meet (and, in fact, has met) with individual entities to discuss their individual financial results, including NCPA. *See Attachment A* to this pleading (January 27, 2007 and February 9, 2007 emails from Jim McClain to the CRR Dry Run participants).

Regarding NCPA, the CAISO has met with NCPA and there are issues specific to NCPA regarding the provision of individual financial results from the CRR Dry Run. First, NCPA is an agency with several municipal and cooperative members but it is not, itself, an LSE. NCPA is a Scheduling Coordinator for its LSE members, and also acted as their agent for purposes of the CRR Dry Run and has communicated to the CAISO its intent to do so again in the upcoming production CRR Allocation process. However, one NCPA member (Silicon Valley Power / the City of Santa Clara) participated in the CRR Dry Run independent of NCPA and its other members, and this fact has complicated the release of financial analysis data in a manner that meets the needs and respects the confidentiality of both Silicon Valley Power and NCPA and its other LSE members. Second, the CAISO has historical scheduling data for NCPA as a whole

³⁰ *Id.* (emphasis added).

³¹ *Id.* at 3.

including Silicon Valley Power, but not for Silicon Valley Power by itself, and therefore it is difficult to perform a correct financial analysis for either entity.³² While each party could potentially perform a meaningful financial analysis themselves, because NCPA represents multiple LSEs, the CAISO cannot simply provide Silicon Valley Power with all the NCPA data without potentially compromising the confidentiality of data related to NCPA's other LSE members. Given these complexities, the CAISO is still working with the parties to determine what data to provide to which parties to enable them to perform the desired financial calculations.

IV. CONCLUSION.

For the foregoing reasons, the CAISO respectfully requests that the Commission reject the comments filed in response to the Dry Run Report as discussed herein.

Respectfully submitted,

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Dated: May 16, 2007

³² For NCPA (without Silicon Valley Power), its MW CRR holdings would be too small relative to its historical scheduling data due to the separate allocation of CRRs to Silicon Valley Power. For Silicon Valley Power, its MW CRR holdings would not have an associated set of scheduling data on which to perform financial analysis.

CERTIFICATE OF SERVICE

I hereby certify that I have this day electronically served a copy of the foregoing document on each party named in the official service list in this proceeding.

Dated at Folsom, CA this 16th day of May, 2007.

/s/ Anna A. McKenna
Anna A. McKenna

ATTACHMENT A

From: McClain, Jim
Sent: Saturday, January 27, 2007 12:40 PM
To: CRR Dry Run
Subject: CRR Dry Run Completion
Dear CRR Dry Run Participants:

This e-mail is to advise you that the results of the April and August CRR Dry Run auction are now available for viewing using the market user interface.

Since we are now done with the monthly auction, this concludes the CRR Dry Run market simulation. We would like to sincerely thank all of you for the tremendous support and cooperation over the last several months as we all worked together to make the Dry Run a success.

The CRR Team is very interested in meeting one-on-one with all CRR Dry Run participants who wish to discuss their individual results. In order to begin the process of having a one-on-one meeting with members of the CRR Team, please send us an e-mail to crrdata@caiso.com and let us know your desire to meet. In addition, please provide a list of questions that you would like to discuss with the CRR Team during the meeting. This will allow us time to do the necessary research to answer questions that are important to you.

As you know, the CRR Team will also be releasing a CRR Dry Run report which will ultimately be filed with the FERC. Next week the CAISO will be meeting to finalize the timing of the next steps, which will include the posting of the CRR Dry Run report and discussions with stakeholders on the results of the CRR Dry Run.

Please let us know if you have any questions.

Thanks,
CRR Team

Jim McClain
Market Operations
Phone 916-608-5809
E-mail jmclain@caiso.com

From: McClain, Jim
Sent: Friday, February 09, 2007 1:21 PM
To: CRR Dry Run
Subject: Individual Meetings to Discuss CRR Dry Run Results

Hi all,

Last month we had put out a notice to see if any of the CRR Dry Run participants wanted to have individual discussions with the CAISO on the results of the CRR Dry Run. We have had several participants request these meetings and they have provided us with the list of questions or issues they wanted to discuss. We are looking at starting to schedule these meetings very soon and wanted to see if anyone else wanted to meet to discuss your results. If you do want to have a meeting please respond to **crrdata@caiso.com** with a list of the questions or issues you would like to discuss.

Thanks,
CRR Team

Jim McClain
Market Operations
Phone 916-608-5809
E-mail jmcclain@caiso.com