



Memorandum

To: ISO Board of Governors
From: Sidney M. Davies, Assistant General Counsel
Anjali Sheffrin, Interim Vice President, Market and Program Development
cc: ISO Officers
Date: October 26, 2005
Re: *Approval of Additional MRTU Issues and Authorization to File MRTU Tariff*

This memorandum requires Board Action.

EXECUTIVE SUMMARY

Management recommends Board approval of the additional MRTU elements summarized in this memorandum and requests Board authorization to file a tariff with the Federal Energy Regulatory Commission that reflects and is consistent with the MRTU design elements approved by the Board or the Commission.

Recommendations are provided for the following additional MRTU design issues:

1. **Existing Zone Generation Trading Hubs.** Management recommends that specific detail be included in the MRTU Tariff concerning the weighting of generation prices to be used in calculating the EZ Gen Hub prices.
2. **Metered Sub-System Issues.** Management recommends that that the Board approve the treatment for MSSs as described in the November 2004 whitepaper.

The MRTU Tariff continues the evolution of the CAISO Tariff, which began in the simplified and reorganized version of the existing ISO Tariff (S&R Tariff), of removing unnecessary detail from the tariff. The MRTU Tariff reflects MRTU design principles and contemplates that implementation details, including guidelines, examples and timelines, be published in the form of Business Practices Manuals (BPMs) and posted on the CAISO website. In addition, the tariff makes one global non-MRTU change of changing the acronym from ISO to CAISO. CAISO Management plans to file the MRTU Tariff on or about November 30, 2005.

BACKGROUND

The CAISO has undertaken the first step in developing a well-organized MRTU Tariff to implement the CAISO's new market design as of February 2007 in the filing of the S&R Tariff on September 22, 2005. The S&R Tariff will be used as the platform for the MRTU Tariff, with the MRTU-specific language identified in "track change" format for filing with the Commission. On October 19, 2005, the CAISO Board approved the remaining 28 issues that complete the CAISO MRTU design. Policy issues included in this memorandum concern additional related areas, such as the composition of EZ Gen Hubs, to allow MRTU Tariff to reflect additional details in these related areas.

The MRTU Tariff will be a complete Tariff insofar as it reflects all elements of a locational marginal pricing market design, including adequate measures to mitigate local market power and congestion hedging instruments in the form of Congestion Revenue Rights. The MRTU Tariff will also include tariff provisions implementing the Resource Adequacy program under development by the California Public Utilities Commission. Since the CPUC has not issued a final decision, the RA-related tariff provisions are likely to evolve between the filing of the MRTU Tariff and implementation of MRTU in February 2007. In addition, RA requirements for non-CPUC jurisdictional entities are still under development. Accordingly, only very general language will be reflected in the tariff concerning RA requirements for non-jurisdictional utilities. It is critical to recognize in this regard that RA issues must be resolved in 2006—well before February 2007 MRTU implementation date. Thus, the ongoing evolution of the details of the RA requirements should not delay the MRTU Tariff filing.

In addition, the MRTU Tariff will not include a reliability capacity backstop product, such as proposed by Independent Energy Producers in EL05-146 or a replacement for the RMR Contract. None of these things should be considered as a “hole” in the MRTU design or the Tariff. The CAISO anticipates working with stakeholders and parties in the near term in this proceeding to develop such a capacity backstop product. In the meantime, the CAISO has tools in its tariff to meet reliability needs, including its existing authority to designate units as Reliability Must-Run Units.

POLICY ISSUES AND RELATED STAKEHOLDER PROCESS

1. *EZ GEN HUBS*

Although Management had recommended deferring the development of the precise definition of EZ Gen Hubs pending further stakeholder development in anticipation that stakeholders would be able to achieve a consensus, it does not appear that any consensus is likely to be achieved. Accordingly, CAISO management has developed and reviewed various formulations and has recommended a specific formulation that is consistent with the CAISO's design principle, which has been approved by FERC, that the price be representative of the price paid to generation in the zone. Importantly, this design principle is consistent with the Settlement Agreements reached in the Seller's Choice proceeding at the FERC in EL04-108. Specifically, CAISO management recommends the formulation described in as Option 1b in the white paper on Trading Hubs (Attachment A hereto). Option 1b would result in the use of two sets of weights for each hub for the entire year, one for peak periods and one for off-peak periods. These weights would be based on the total annual (peak or off-peak) metered generation output of all generating resources within the hub. Many stakeholders support, in general, an approach that uses weighted averages. Another significant stakeholder group support use of a simple average, arguing that it would be more stable. Although no consensus exists on the appropriate definition, many stakeholders objected to the more vague language provided in the draft tariff that the EZ Gen Hub prices would be based on the “average price” without specifying the type of average to be used (weighted or simple). CAISO management believes that it is in the best interests of the market to file a more precise definition at this time, and that the use of a weighted average better represents the average price paid to generators and provides sufficient specificity to present to FERC.

2. *MSS Issues*

Since June 2003 when the CAISO filed its comprehensive MRTU conceptual design proposal, the CAISO has continued to refine MRTU issues as they relate to Metered Sub-Systems (MSS). MSS exist and are operating today, but the tariff provisions governing their operation and settlement require modification to be consistent with the MRTU design. During 2004 the CAISO held extensive discussions with stakeholders to specify how MSS would work under MRTU, and this process resulted in the November 19, 2004 MSS white paper documenting specific policies related to

MSS under MRTU (Attachment B hereto). Management's recommendations on MSS under MRTU are set forth in this white paper.

LECG performed a review of the MRTU Market Design (published on February 23, 2005) in which it identified an issue regarding the Load Aggregation Point (LAP) structure in relation to MSS. In particular, the November 19, 2004 MSS white paper proposed that an MSS would have the option to settle its generation and load on either a gross basis or a net basis. An MSS that has elected net settlement would be settled at the LAP price for positive net load and at the MSS locational price for positive net generation. The identified problem occurs when the MSS is located in an area where the locational price tends to be higher than the LAP price due to congestion coming into the MSS area, and the MSS tends to be a net load. In such a case an inefficient incentive is created; specifically, there is no incentive for MSS to operate its local higher priced generation to help relieve congestion because that generation will implicitly earn only the LAP price (i.e., by offsetting local MSS load) rather than the higher locational price.

Earlier this month CAISO staff engaged MSS stakeholders to address the issue identified by LECG, and hosted a meeting on October 26 to consider a proposal that would address the issue by settling any net demand for an MSS that has elected net settlement at the MSS locational price rather than the applicable IOU-level LAP. Since the problematic incentive is not present for an MSS that chooses to settle based on gross supply and demand, an MSS that elects gross settlement may choose to settle demand at the larger IOU-level LAP. In addition, one further modification to the November 2004 MSS white paper is required to meet the needs of "load-following" MSS, i.e., MSS that elect to follow their load with their own resources in Real Time. Specifically, management is considering clarifying and expanding the settlement options available to a load following MSS to include the option to settle based on gross supply and demand rather than requiring the load following MSS to settle based on its net demand, as stated in the November 2004 white paper. Although these modifications are currently in progress, management does not believe they can be worked through in all the detail necessary in time for inclusion in the November MRTU Tariff filing. Management therefore recommends that the Board approve the proposal as provided in the November 2004 white paper to be filed in the November MRTU Tariff filing while management continues to work with stakeholders to finalize the modifications needed to address the LECG issue.

MRTU TARIFF STAKEHOLDER MILESTONES

April 2005

- CAISO posted whitepaper on MRTU Tariff process, including an explanation of the development of the S&R Tariff as a step in that process.
- Presentation to stakeholders regarding MRTU Tariff process at the April 12-13 stakeholder meetings.

May 2005

- Presentation to stakeholders updating MRTU Tariff process at the May 18-19 stakeholder meetings.
- Part 1 of MRTU draft tariff language including the following subjects: CAISO Markets, Bids and Bid Submission, Day-Ahead Market, Residual Unit Commitment, Real Time Market, Constrained Output Generators on May 6

June 2005

- Presentation to stakeholders updating MRTU Tariff process at the June 21-23 stakeholder meetings.

July 2005

- Presentation to stakeholders updating MRTU Tariff process at the July 13-14 stakeholder meetings.

- Part 2 of MRTU of MRTU draft tariff language including the following subjects: Hour-Ahead Scheduling Process, Inter-Scheduling Coordinator (SC) Trades of Energy, Inter-SC Trades of AS Obligations, Market Power Mitigation Procedures and Metering on July 1

August 2005

- Presentation to stakeholders updating MRTU Tariff process at the August 16-18 stakeholder meetings.

September 2005

- Re-release of revised MRTU Sections previously released and release of new draft tariff language on Existing Transmission Contracts and Transmission Owner Rights on September 12, 2005
- Release draft MRTU language on Settlements

October 2005

- Posted complete draft MRTU tariff on October 1 2005
- MRTU Tariff drafting workshop with stakeholder participation October 24-28.
- Follow-up meetings with stakeholders—to be determined

November 2005

- Near-final MRTU Tariff posted for information week of November 14
- Follow-up meetings with stakeholders—to be determined
- MRTU Tariff filing November 30, 2005

STAKEHOLDER PROCESS

In the course of developing the MRTU Tariff, the CAISO has conducted a more robust stakeholder process devoted to Tariff development since prior to market start-up in 1998. MRTU Tariff Team began posting key sections of draft MRTU language in May. Additional Parts were posted throughout the summer culminating in the posting of a complete draft of the MRTU Tariff posted on October 11. Since October 11, MRTU Tariff and Policy Teams have continued to revise the tariff to reflect the policies approved by the Board at the October 19, 2006 meeting. During the October 24-28 meetings, the CAISO is engaging with stakeholders in a review of the draft tariff provisions relating to MRTU to ensure consistency with policies approved by the Board of the Commission. The MRTU Tariff team will continue to improve the document and intends to post a near final draft version of the MRTU Tariff during the week of November 14, for informational purposes. The MRTU Tariff team intends to schedule additional meetings with stakeholders in the event topics scheduled for the October 24-28 workshops get deferred.

Many stakeholders have been actively engaged in the MRTU Tariff stakeholder process, though the tariff effort has not been the main focus of stakeholders this summer and fall. Policy issue resolution took center stage. However, the MRTU Tariff team worked closely with the MRTU Policy team to help resolve issues and capture MRTU design elements in tariff language. A small but dedicated group of stakeholders provided extensive comments and suggestions in writing and orally during stakeholder meetings in response to tariff postings. All stakeholder questions and comments that the CAISO has received in writing have been captured in a spreadsheet. To date the CAISO has provided written responses to most of the stakeholder questions received on draft tariff language posted in May and July and will continue to review and respond to stakeholder questions during and following the MRTU Tariff workshop scheduled for October 24-28 both orally and in writing.

During the October 24-28 MRTU Tariff workshop, stakeholders are able to ask questions while CAISO attorneys and policy experts review and revise the draft tariff language. The goal of the workshop is to ensure consistency in two respects: first, between the MRTU Tariff and policies approved by the Board and the Commission; and second, internal consistency to ensure various sections of the Tariff that implement the main elements of MRTU are consistent with each other and the rest of the tariff, which contains legacy language that in some instances will need to be revised or deleted, as appropriate to ensure consistency with MRTU.

STAKEHOLDER COMMENTS

Specific stakeholder comments on draft tariff language fall into four types: specific edits (typos and word-smith suggestions); questions on consistency between sections; questions whether the tariff has sufficient detail on specific issues; questions whether the tariff has captured the most recent policy decisions. CAISO has answered many of these questions in writing and is addressing these types of concerns during the MRTU Tariff workshop to the extent they have not previously been addressed. CAISO staff intends to continue to respond to questions as long as it can be done without jeopardizing the November 30, 2005 filing date.

General stakeholder comments and concerns relate to the level of detail that needs to be in the tariff and the related fact that the proposed Business Practices Manuals (BPMs) are not yet available. As previously presented to the Board, management's vision of a well-organized MRTU Tariff for the CAISO entails eliminating unnecessary details from the tariff and developing useful, accurate and detailed BPMs that are not on file with FERC but yet fully supported by tariff language. Management now proposes to delete additional unnecessary detail—primarily the appendices to the protocols that remain following the integration of the Protocols into the tariff as part of the S&R Tariff process. This includes appendices to the Settlements Protocol, which consist mainly of settlements formulae, and appendices to the Metering Protocol and other details not generally included in a tariff.

The MRTU Tariff team has reviewed the level of detail in tariffs of other independent system operators and regional transmission operators, which has been accepted by FERC, and has endeavored to capture a similar level of detail in the MRTU tariff. The MRTU Tariff will contain all rates, terms and conditions that must be on file with FERC. Further, other ISO/RTOs employ manuals where implementation details are covered. Stakeholders have already raised these concerns to the Board and management has made a commitment to have final BPMs in place by October 2006.

The other general area of concern relates to the stakeholder process for developing and amending BPAs. Proposed section 22.11 significantly expands upon existing Section 16.2, which merely provides the Board shall establish an amendment process for protocols. Proposed section 22.11 provides:

Operating Procedures and Business Practices Manuals Development and Amendment Process.

The CAISO shall prepare, maintain, promulgate, and update the Operating Procedures and Business Practices Manuals. The Operating Procedures and Business Practices Manuals shall be consistent with the CAISO Tariff, and any NERC or WECC operating policies, guidelines and standards, and shall be available on the CAISO's website. The CAISO Governing Board shall establish a stakeholder process in order to ensure that all affected parties have an opportunity to comment on any Business Practices Manual. Under that process, the CAISO and stakeholders shall consider whether any amendments to the CAISO Tariff are necessary in order to ensure the consistency of the CAISO Tariff and the Business Practices Manuals. The CAISO Governing Board may direct the CAISO to file for acceptance at the FERC of any necessary amendment to the CAISO Tariff to ensure that the Business Practices Manuals are supported by adequate authority under the CAISO Tariff.

Some stakeholders have requested a notice period prior to an effective date. Other stakeholders have suggested that the Board should approve amendments to the BPMs. Management believes the proposed language affords adequate due process to market participants. A mandated notice period should not be hard wired. Some changes—if reliability based—may need to be made with little if any notice. Other changes may simply involve corrections. All changes must be fully consistent with existing Tariff language. The proposed tariff language places an affirmative duty upon management to consider whether existing authority is adequate and, if not, management is obliged to pursue a tariff amendment. Moreover, the proposed tariff language allows for the development of a stakeholder process, which effort is currently underway that should ensure adequate due process.

Finally, the MRTU Tariff does make on non-MRTU change: it changes the acronym for the California Independent System Operator Corporation from ISO to CAISO. The term “independent system operator” is a generic term and there are a number of “ISOs” in existence. The California ISO needs a unique acronym.

MOVED,

That the ISO Board of Governors approves the further MRTU policy proposals, and authorizes the filing of the MRTU Tariff as outlined in the memorandum dated October 26, 2005.