

Comments to the CAISO Board
By the California Department of Water Resources
CAISO Uneconomic Adjustment Initiative
July 9, 2008

The California Department of Water Resources (CDWR) wishes to express its concern about the serious effect the California Independent System Operator's (CAISO) Uneconomic Adjustment Initiative (Initiative), also known as the Parameter Tuning proposal, would have on State Water Project (SWP) water delivery operations.

SWP Operations

SWP manages water for the State, including flood control and water deliveries to more than 29 million Californians. SWP's operations are contingent upon satisfying many environmental conditions. Its critical missions require that SWP's facilities are able to operate during all other times. CAISO curtailments of energy schedules to critical plants (especially during periods of drought such as this year) raise extremely serious health, safety, and environmental concerns.

SWP has retained Existing Transmission Contracts (ETCs) to ensure that energy schedules for its load and generation maintain their firm status so that these facilities can be operated when necessary for water operations, and not curtailed for economic reasons. Further, SWP has preserved its ETCs to avoid exposure to volatile Locational Marginal Prices (LMP).

CAISO Initiative

SWP believes that CAISO's Initiative will have the following negative outcomes for SWP's operations: (1) loads scheduled on nodally-priced high priority firm transmission service are now more vulnerable to curtailment than loads scheduled on lower priority economic-based transmission service; and (2) any portion of the schedule that would now become unbalanced due to this Initiative would now be exposed to an increased risk of undesirable economic outcomes.

Treatment of ETC Schedules by CAISO's Initiative

The consequence of: i) the MRTU design choice; and ii) the implementation of this Initiative over all self-schedules; is that it fails to maintain the legal obligation to honor ETCs and TORs. With this proposal to cut ETC/TOR schedules before exhausting economic bids, CAISO can unilaterally curtail ETCs and TORs to prevent the CAISO market from reaching high LMP prices. As a result, an ETC or TOR schedule will lose the certainty that it was guaranteed to receive and lose its protection from LMP spikes.

CAISO's Initiative departs significantly from the commitment to honor firm transmission rights that was an essential part of the stakeholder consensus that led to the creation of CAISO, i.e., Assembly Bill 1890 that authorized creation of CAISO, and FERC orders approving establishment of CAISO. In addition, the Energy Policy Act of 2005 expressly provides that no ISO in the Western Interconnect may force customers to employ financial firm transmission rights in lieu of their ETCs. The Initiative also stands in

contrast to CAISO's guarantee in the February 2006 MRTU filing that an ETC/TOR customer:

“has the full assurance that it will be able to transmit power between its chosen receipt and delivery points without service interruption (absent force majeure or curtailment) and without being subject to any additional cost”.

Furthermore, the Initiative contravenes the agreements with ETC holders when they accepted CAISO's Perfect Hedge proposal that was a critical policy aspect underlying stakeholder support for MRTU.

Treatment of Participating Load by CAISO's Initiative

Although not explained in CAISO's initial and revised White Papers on the Initiative, recent discussions with CAISO staff have revealed that the Initiative will similarly target Participating Load (which provides demand response to the CAISO system) for curtailments not applied to LAP loads. This is because CAISO finds it more effective to curtail specific loads that are nodally scheduled and priced than to curtail LAPs, whose geographic range encompasses the investor owned utilities' service areas.

Electric Reliability Implications

Lastly, if CAISO implements this Initiative and unilaterally orders curtailment of firm SWP load that has not provided a market bid, then the load will have been forced into an involuntary blackout in order to respond to a market situation and CAISO will need to report such blackout of load to NERC. SWP will also be constrained to comply with such applicable electric reliability reporting requirements.

Conclusion and Recommendations by DWR

If the CAISO is implemented without modification, the Initiative:

- i) would violate ETCs/TORs;
- ii) could expose ETC/TOR holders and Participating Load to undesirable economic outcomes;
- iii) could have a serious negative impact upon SWP's ability to meet environmental requirements and its primary mission of providing water to millions of Californians; and
- iv) raises questions about reliability of firm service on the California grid.

Thus, CDWR strongly urges the CAISO Board to fully consider the consequences of this Initiative and we request CAISO include in this Initiative all of the following three recommendations, in their entirety:

1. Apply the Initiative only to non-ETC and non-TOR self-schedules. This way, entities that choose to self-schedule rather than submit an economic bid will have an incentive to submit the bid. This also avoids CAISO interference with ETC/TOR performance.
2. Revise LAP implementation to require that loads in load pockets are scheduled on a basis that is as granular as CAISO's Load Distribution Factors. The pricing objective of LAP can still be retained. This would also assist CAISO in eventually being compliant with FERC's directives that CAISO develop greater granularity in its treatment of loads under LMP.
3. Allow upon notice to CAISO of exigent circumstances, a temporary exclusion from this Initiative. Those loads and generation that have hydrological flow, environmental, irrigation, and water supply requirements according to applicable federal or State laws, regulations, or other governing jurisdictional authority that could include declared water emergencies by the Governor, must be capable of being temporarily excluded from this Initiative when notified of such status by an entity to CAISO.

The inclusion of a flagging methodology would enable such notification, akin to existing contingency flags for Ancillary Services. The CAISO should expedite development of this methodology. Entities that have such load and generation would use such flags to signal to CAISO when CAISO must exercise all measures necessary to honor the schedules of such load and generation, including temporary exclusion from this Initiative.

Existing protocols that permit CAISO to make out-of-market requests to DWR for adjustments of such flagged resources can be continued to implement this Initiative. SWP would then be able to consider the impacts to water delivery commitments and environmental restrictions before determining whether it can accept such adjustments.