CALIFORNIA ISO

California Independent
System Operator

April 3, 2006

Via Electronic Filing

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Long-Term Firm Transmission Rights In Organized Electricity Markets

Long-Term Transmission Rights in Markets Operated by Regional Transmission Organizations and Independent System Operators

Docket Nos. RM06-8-000 and AD05-7-000

Dear Secretary Salas:

Transmitted herewith for electronic filing in the above-referenced proceeding is the Reply Comments Of The California Independent System Operator Corporation On Notice Of Proposed Rulemaking in the above-referenced dockets.

Thank you for your attention to this matter.

Yours truly,

/s/ Anna A. McKenna
Anna A. McKenna

Counsel for the California Independent
System Operator Corporation

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Long-Term Firm Transmission Rights In Organized Electricity Markets	)	**Docket Nos. RM06-8-000 and AD05-7-000**
Long-Term Transmission Rights in Markets Operated by Regional Transmission Organizations and Independent System Operators	)	

REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON NOTICE OF PROPOSED RULEMAKING

The California Independent System Operator Corporation ("CAISO") hereby submits these reply comments in response to the Notice of Proposed Rulemaking ("NOPR") issued by the Federal Energy Regulatory Commission ("Commission") in the above captioned proceeding on February 2, 2006. In the NOPR, the Commission proposes to implement a requirement specified in the Energy Policy Act of 2005 ("EPAct 2005") that Transmission Organizations with organized energy markets develop long-term firm transmission rights (or equivalent tradable or financial rights) ("LT FTRs").

The CAISO urges the Commission to allow the CAISO and its participants to gain sufficient experience with the redesigned markets based on Locational Marginal Pricing ("LMP") being implemented under the CAISO's Market Redesign and Technological Upgrade ("MRTU") project, which are scheduled to begin full operation on November 1, 2007. Because the CAISO is in the midst of a comprehensive market redesign, including a transition to LMP from the current zonal market design, a Commission requirement that the CAISO implement LT FTRs prior to one year after the start-up of the LMP markets would be problematic, as well as disruptive to the MRTU implementation effort.[1] Further, as reflected in the comments submitted by California parties, CAISO market participants hold divergent views on the issue of LT FTRs. Because of this diversity of views, the CAISO believes it is vital that the Commission provide the CAISO and its stakeholders with ample opportunity to engage in a meaningful stakeholder process to consider the development of LT FTRs. The CAISO also requests that the Commission hold a technical conference prior to the Final Rule to allow further discussion of certain aspects of LF FTRs that may be common to all Transmission Organizations with organized energy markets. Finally, the Commission should not consider in this NOPR the merits of physical rights versus financial rights because that issue is entirely outside the scope of this proceeding.

I. Comments

A. The CAISO Should Be Allowed to Explore Long-Term Congestion Revenue Rights ("CRRs") with its Stakeholders, for Possible Implementation No Sooner Than One Year After the Start of MRTU.

As discussed in the CAISO's initial comments on the NOPR, the CAISO has three primary concerns regarding the implementation of LT FTRs. First, the CAISO should not be required to implement, prior to the start-up of the MRTU markets, a hybrid instrument that would have to work effectively both in the zonal markets that exist today and in the LMP markets that will be in place once MRTU is implemented. Second, it is critical that the CAISO be given sufficient time to discuss with stakeholders their needs for long-term CRRs and the pros and cons of alternative designs. Third, the CAISO should not be required to implement long-term CRRs before having at least one year of

[1] The CAISO's MRTU Tariff is currently pending before the Commission in Docket No. ER06-615-000.

experience with the LMP markets. The aforementioned concerns derive directly from the fact that the CAISO and its stakeholders are now fully engaged in preparing to implement, on November 1, 2007, a comprehensive redesign of the CAISO's markets based on the LMP paradigm. Within this context, the CAISO intends to initiate discussion of long-term CRRs with stakeholders later this year as part of the scoping of a "Release 2" of MRTU. Release 2 features of MRTU would be implemented some time after the start-up of the LMP markets.

The Commission should not be swayed by parties who argue that it would be in the interest of all CAISO stakeholders for the CAISO to adopt and implement LT FTRs as early as this fall.[2] The adoption of LT FTRs prior to the start of MRTU would require the CAISO to develop a long-term hybrid instrument that would initially reflect the current Firm Transmission Rights ("FTRs") applicable in the zonal CAISO markets and then several months later would have to be adaptable to the LMP-based CRRs that will be implemented under MRTU. Parties requesting that the Commission direct the CAISO to develop such a hybrid instrument offer no recommendations whatsoever on the design of such an instrument, nor do they explain how it would even be feasible to develop and implement such instruments through a meaningful stakeholder process in the time frame they envision.

The Commission must recognize that it would be difficult and complicated to develop such a hybrid instrument. Further, such an effort would require the CAISO to divert its own and its stakeholders' limited resources – which are already fully

[2] Comments of Sacramento Municipal Utility District, Docket No. RM06-8-000, submitted March 13, 2006 ("SMUD Comments") at pp. 33-34; and Comments of the Los Angeles Department of Water and Power on Long-term Transmission Rights, Docket Nos. RM06-8-000 and AD05-7-000, submitted March 13, 2006 ("LADWP Comments"), at p. 7.

encumbered by preparation for the LMP start-up – towards an effort that would satisfy at best the requests of a limited number of parties.

Additionally, it is important that Commission not direct the CAISO to implement LT FTRs before CAISO market participants have had a sufficient demonstration of what CRRs they will be able to receive under the CRR proposal under MRTU. The CAISO previously conducted CRR Studies 1 and 2 with its market participants, and these studies provided valuable insight into the CAISO's proposed CRR allocation process.[3] The value of these studies as accurate predictors of actual CRR allocation and hedging effectiveness is limited, however, because the methodology for these studies had to be established before the CRR allocation rules proposal filed on February 9, 2006 was finalized through the stakeholder process. The CAISO is planning a complete CRR Dry Run based on the filed CRR allocation rules to allow parties to gain a more realistic assessment of the CRR coverage they can expect under these rules. Although the CAISO is still developing its proposed schedule for the CRR Dry Run, the CAISO does not expect the CRR Dry Run will be completed before the first quarter of 2007. The CAISO expects the results of the CRR Dry Run to be valuable to inform discussions about the need for and design of long-term CRRs. Moreover, as discussed in the CAISO's initial comments in this NOPR, the proposed CRR allocation rules contain a feature that aligns with the objectives of LT FTRs. This feature is a priority nomination run that allows parties to re-nominate CRRs that were allocated to them in the prior year and then provides them the results prior to the runs to allocate new CRRs. The CRR Dry Run results will allow parties to determine how much of their coverage will benefit from to this longevity aspect of the CRR allocation rules. In summary, the lack of

[3] All reports and studies associated with CRR Study 1 and 2 can be found at http://www.caiso.com/docs/2004/01/29/2004012910343827511.html.

experience with LMP markets and CRRs -- in addition to parties not having good estimates at this time of what CRRs they will actually receive -- is a major reason why many CAISO participants have not been supportive of implementing CRRs with more than a one-year term upon MRTU start-up.[4]

B. The CAISO Supports the Recommendation of the CPUC and Other Parties that the Commission Convene a Technical Conference to Allow Transmission Organizations and Their Participants to Explore LT FTRs in the Context of Organized Energy Markets.

The CAISO believes there would be great value for the existing independent Transmission Organizations and all parties who participate in their organized energy markets to meet in the context of a Commission-sponsored technical conference to discuss alternative approaches to the design of LT FTRs in such markets, and to address the many questions and issues raised in the initial round of comments on the NOPR. Drawing on the knowledge and experience of a diverse group of participants would be extremely beneficial and would better in inform the CAISO, and others, of the various approaches to designing LT FTRs.

C. Arguments Regarding the Merits of Physical Rights versus Financial Rights Are Outside the Scope of this NOPR as EPAct 2005 Explicitly Suggests that Financial Rights Would Satisfy the LT FTR Requirements.

Arguments raised by SMUD, LADWP, SVP, and TANC[5] regarding the superiority

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[4] Comments of San Diego Gas & Electric Company on FERC's Notice or Proposed Rulemaking (NOPR) Concerning Long-Term Firm Transmission Rights in Organized Electricity Markets, Docket Nos. RM06-8-000 and AD05-7-000, submitted March 13, 2006, at p. 2; Comments of Southern California Edison Company, Docket Nos. RM06-8-000 and AD05-7-000, submitted on March 13, 2006, at p. 4; Notice of Intervention and Comments of the Public Utilities Commission of the State of California, Docket No. RM06-8-000, submitted on March 13, 2006, at II. B.

[5] SMUD Comments at pp. 29-38; LADWP Comments at p. 6-7; Comments of the City of Santa Clara, California, Silicon Valley Power, on Notice of Proposed Rulemaking on Long-term Transmission Rights on Organized Electricity Markets, Docket Nos., RM06-9-000 and AD05-7-000, submitted March 13, 2006, at pp. 8-9, 13; and Comments of the Transmission Agency of Northern California, Docket Nos. RM06-8-000 and AD05-7-000, submitted March 13. 2006, at pp. 7-12.

of physical as opposed to financial transmission rights are outside the scope of this NOPR because the EPAct explicitly contemplates that financial rights can satisfy the LT FTR requirements. The arguments submitted by these parties against financial rights are nothing more than collateral attacks on the development of LMP-based markets (and on the accompanying financial transmission rights that are designed to hedge the congestion costs associated with such markets), and should not be countenanced by the Commission.

It is wholly inappropriate for parties to mount collateral attacks on financial rights in the context of this NOPR, because the EPAct explicitly recognizes indicate the appropriateness of financial rights as a viable alternative to physical rights. In that regard, new section 217(b)(4) of the FPA provides:

> The Commission shall exercise the authority of the Commission under this Act in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities to satisfy the service obligations of the load-serving entities, and enables load-serving entities to secure firm transmission rights (<u>or equivalent tradable or financial rights</u>) on a long-term basis for long-term power supply arrangements made, or planned, to meet such needs.[6] [emphasis added]

A plain reading of the statute clearly indicates that Congress had intended to allow for ISOs and RTOs to "meet the reasonable needs of load-serving entities to satisfy the service obligations of the load-serving entities" through the use of "tradable financial rights." Therefore, any attempt by SMUD, TANC, LADWP, or SVP to limit the development of financial rights or impose physical rights should be viewed by FERC as counter to its mandate under EPAct.

[6] Pub. L. No. 109-58, § 1233, 119 Stat. 594, 958.

D. The Commission Should Allow The CAISO To Work With Stakeholders And Neighboring Control Areas To Identify And Address Seams Issues In A Comprehensive Manner.

The CAISO is fully aware that "seams issues" exist today between neighboring control areas, and acknowledges that focused collaborative efforts are needed to address them. To that end, CAISO is committed to working with its stakeholders and neighboring control areas to address these issues. That being said, the CAISO submits that there is no basis to the argument that its implementation of LMP-based markets with financial transmission rights will cause or exacerbate any specific seams issues. In any event, the CAISO believes that substantial progress can be made in mitigating seams issues by working collaboratively with other control areas in the west to address seams issues in a comprehensive manner. For example, the CAISO believes it would be mutually beneficial for western control areas to establish coordinated exchanges of day-ahead scheduling information. Such exchanges can improve the accuracy of day-ahead congestion management and thereby reduce real-time unscheduled flows and the need for real-time mitigation procedures, and this would benefit all control areas regardless of whether they have organized energy markets, LMP-based or otherwise, and without the need to impose a physical rights model for the entire region.[7]

In summary, the CAISO recognizes that significant seams issues exist today, and is ready and willing to work with parties to address them. It is,

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[7] During 2003 the CAISO participated in a working group as part of the SSG-WI activities to develop a conceptual design for west-wide day-ahead congestion management to minimize real-time unscheduled flows. The results of this effort were published and discussed publicly. This is described in a CAISO memorandum, which can be found at http://www.caiso.com/docs/09003a6080/28/5b/09003a6080285b82.pdf#search='SSGWI%20Congestion. The CAISO believes that this conceptual design is still relevant and needed.

however, crucial to look at seams issues in a more comprehensive manner, not in a piecemeal manner, and to identify specific solutions and demonstrate clearly how such solutions will address specific problems.

One final point must be made. To address seams issues, CMUA requests that the Commission consider in its Final Order that "the Western Electricity Coordinating Council itself, neighboring Control Areas, and relevant transmission owners throughout the relevant geographic market for power in the West" be included in the regional stakeholder discussion on LT FTRs.[8] The CAISO has never discouraged such parties from participating in its stakeholder processes and would not do so in the future.

[8] Initial Comments of the California Municipal Utilities Association, Docket No. RM06-8-000, submitted March 13, 2006, at p. 14.

II. Conclusion

For the forgoing reasons, the CAISO requests that: (1) the Commission allow the CAISO to explore long-term CRRs with its stakeholders, for possible implementation no sooner than one year after the start of MRTU; (2) the Commission establish a technical conference prior to issuing a Final Rule; and (3) the Commission not entertain any arguments regarding the merits of physical rights versus financial rights because such issue is entirely outside the scope of this proceeding.

Respectfully submitted,

/s/ Anna A. McKenna

Charles F. Robinson
Vice President, General Counsel and Corporate Secretary
Anthony J. Ivancovich
Assistant General Counsel – Regulatory
Anna A. McKenna
Counsel

The California Independent System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630

Tel.: (916) 355-4400
Fax: (916) 351-4436

Dated: April 3, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have, this 3rd day of April 2006, caused to be served a copy of the forgoing document upon all parties listed on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

/s/ Anna A. McKenna
Anna A. McKenna