



California Independent
System Operator Corporation

August 8, 2008

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

Re: Amendments to MRTU Tariff Provisions, Docket No. ER08-1113-000.

Dear Secretary Bose:

On July 23, 2008, the California Independent System Operator Corporation (“CAISO”) filed an answer to the motions to intervene, comments and protests filed by various entities in the above-captioned proceeding. Between July 29, 2008 and August 7, 2008 nine entities filed answers to the CAISO’s July 23, 2008 Answer.¹ Enclosed for filing in the above-referenced docket is the CAISO’s Motion for Leave to File Answer and Answer to the pleadings filed in between July 29, 2008 and August 7, 2008. Thank you for your assistance in this matter.

Respectfully submitted,

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¹ On July 29, 2008, the Transmission Agency of Northern California (“TANC”), the Sacramento Municipal Utility District and the Turlock Irrigation District (jointly), and the Modesto Irrigation District filed answers to the CAISO’s July 23, 2008 Answer. On July 30, 2008, the City of Santa Clara, California doing business as Silicon Valley Power filed an answer to the CAISO’s July 23, 2008 Answer. On July 31, 2008, the Northern California Power Agency filed an answer to the CAISO’s July 23, 2008 Answer. On August 1, 2008, the City and County of San Francisco filed an answer to the CAISO’s July 23, 2008 Answer. On August 6, 2008 the Western Area Power Administration filed an answer to the CAISO’s July 23, 2008 Answer, and TANC filed a Supplement to its July 8, 2008 protest. On August 7, 2008 the U.S. Department of Energy (“DOE”) filed an answer to the CAISO’s July 23, 2008 Answer.

of Energy (“DOE”) filed an answer to the CAISO’s July 23, 2008 Answer. Set forth below is the CAISO’s motion for leave to file an answer and answer to the pleadings filed by TANC, SMUD-TID, MID, SVP, NCPA, CCSF, Western, and DOE between July 29, 2008 and August 7, 2008.

Regarding the date by which the CAISO needs Commission action on the IBAA proposal, the CAISO notes that the date has changed due to a change in the projected start date for MRTU. The CAISO recently has determined that a 2008 Fall start for MRTU is not feasible.² At this time the CAISO has not yet announced a new projected start date for MRTU, but it is certain that MRTU will not go live in 2008. In the July Board of Governors meeting, stakeholders requested that the CAISO factor in three months of stability of the market systems prior to the start of MRTU. The CAISO is continuing to actively and vigorously resolve MRTU implementation issues and is working to be prepared to provide the three month system stability sought by participants. As previously stated, it takes about six weeks to implement changes to the FNM and successfully launch the FNM into the market environment.³ In light of these circumstances, the date by which Commission action is needed on the IBAA proposal is now September 26, 2008.⁴

II. MOTION TO FILE ANSWER

Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2007), the CAISO hereby requests leave to file this answer to: the July 29, 2008

² See the August 2008 Status Report of the California Independent System Operator Corporation filed in Commission Docket No. ER06-615 at 2.

³ See Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 45.

⁴ Six weeks from September 26, 2008 is November 7, 2008 and there are twelve weeks between November 7, 2008 and February 1, 2009 which allows for three months of market simulation testing.

Answers of TANC, SMUD-TID, and MID; the July 30, 2008 Answer of SVP; the July 31, 2008 Answer of NCPA; the August 1, 2008 Answer of CCSF; the August 6, 2008 Answer of Western; the August 6, 2008 Supplement by TANC to its July 8, 2008 protest; and, the August 7, 2008 Answer of DOE. The CAISO requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to answer the answers. 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.⁵

III. ANSWER

A. The Compelling Need for the IBAA Proposal and Commission Action on the IBAA Proposal

TANC states that there is no need for the Commission to act on the IBAA proposal “both because the ISO is not ready for MRTU implementation, and the ISO has not shown a compelling need for the IBAA proposal.”⁶ In asserting that the CAISO has not demonstrated a compelling need for the IBAA proposal, TANC states that:

[t]he ISO has offered not: an iota of evidence, either in its June 17 filing or in its July 23 Answer, that the entities within the IBAA or the transmission customers of those entities *will schedule improperly with the intent or effect of damaging the ISO markets* or imposing unwarranted costs on the ISO or its customers. *Based upon entirely theoretical constructs*, the ISO simply maintains that the IBAA proposal is a necessary idea and that it urgently needs Commission action to allow for system testing.⁷

⁵ See, e.g., *Entergy Services, Inc.*, 116 FERC ¶ 61,286 at P 6 (2006); *Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,124 at P 11 (2006); *High Island Offshore System, L.L.C.*, 113 FERC ¶ 61,202 at P 8 (2005); *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corp.*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Co.*, 93 FERC ¶ 61,098, at 61,259 (2000).

⁶ TANC Answer to Answer at 9 (P 19).

⁷ TANC Answer to Answer at 9 (P 20) (emphasis added).

Similarly, SMUD states that there is “no dispute that the potential concerns about ‘inappropriate scheduling incentives’ that the CAISO claims to have prompted its filing are currently hypothetical.”⁸ SMUD claims that what governs is:

not the CAISO’s predilections to address hypothetical ‘market behavior concerns,’ but the Commission’s precedent – cited in SMUD’s protest – holding that market initiatives should, in fact be designed to address real, not merely theoretical concerns.⁹

Contrary to the statements of SMUD and TANC, there is a compelling need for the IBAA proposal and there is a need for the Commission to act on the IBAA proposal.

1. The CAISO Has Demonstrated a Compelling Need for the IBAA Proposal

Based on the collective input from Dr. Hildebrandt in the CAISO’s Department of Market Monitoring (“DMM”), the opinion of the CAISO’s Market Surveillance Committee (“MSC”) and the testimony of Dr. Harvey regarding the experience of the Independent System Operators (“ISOs”) and Regional Transmission Organizations (“RTOs”) in the east dealing with the issue of pricing interchange transactions under an LMP regime, the CAISO presented substantial evidence that it cannot ignore the potential negative pricing consequences of either radial modeling (*i.e.*, modeling resources as if they are physically located at or near each Intertie Scheduling Point between the IBAA and the CAISO Controlled Grid) as espoused by the IBAA Entities¹⁰ or a multiple hub proposal.¹¹ The CAISO stated that:

⁸ SMUD Answer to Answer at 9.

⁹ *Id.* (citations omitted).

¹⁰ “IBAA Entities” is a collective reference to the SMUD BA, the TID BA, Western and TANC. TANC, in turn, is a joint powers agency authorized by Section 6502 of the California Government Code and is composed of the California cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara, and Ukiah; the Plumas-Sierra Rural Electric Cooperative; SMUD; MID, and TID.

It literally is impossible for the CAISO to ignore the testimony of Dr. Harvey and Dr. Hildebrandt and the MSC, all of whom explain that granting the desire of the IBAA entities to have their transactions modeled and priced as if the injection is physically at the Intertie Scheduling Point is tantamount to requiring that the CAISO ratepayers pay a price for power calculated based on the “most favorable” assumptions to the IBAA entities regarding the location of the generation supporting imports from their Balancing Authority Area in *all* circumstances, regardless of whether or not the imports are actually supported by generation whose location warrants the higher price. The IBAA entities should not be permitted to fail to provide the CAISO with the information it needs to accurately price and model interchange transactions and then reap the benefits of that non-transparency by receiving LMPs that are favorable to them only because of the CAISO’s inability to accurately reflect such transactions due to a lack of information.¹²

With regard to SMUD’s and TANC’s claim that the need for the IBAA proposal is based on “entirely theoretical constructs”¹³ the CAISO provided evidence that the concerns regarding inefficient scheduling incentives are not hypothetical; the problems have repeatedly manifested themselves in the eastern interconnection across scheduling points spanning much larger geographic and electrical distances than those at issue with the pricing of interchange between the CAISO and the SMUD and TID BAA.¹⁴ Dr. Harvey specifically recounts the experience of the eastern ISOs and RTOs that all successfully use proxy bus mechanisms (analogous to the CAISO’s IBAA proposal) to analyze and price the congestion impacts of interchange schedules.¹⁵ Dr. Harvey also explains how the use of proxy bus mechanisms by the eastern ISOs and RTOs evolved over time in response to changing circumstances and the behavior of market

¹¹ See, e.g., Transmittal Letter to the June 17 Filing at 3-11 (including the material and authorities cited therein).

¹² *Id.* at 7.

¹³ TANC Answer to Answer at 9 (P 20).

¹⁴ Transmittal Letter to the June 17 Filing at 9.

¹⁵ Exhibit ISO-3, Testimony of Dr. Harvey at 31-40.

participants.¹⁶ With regard to whether the issues that arose with the eastern ISOs and RTOs regarding inefficient scheduling incentives would arise in California under MRTU, Dr. Harvey states that:

[t]here is no question that if presented with different prices at alternative scheduling points with a single Balancing Authority Area, market participants will schedule transactions along a contract path external to the Balancing Authority Area to the scheduling point with the most favorable price. This kind of behavior has been repeatedly observed and continues to be observed in other markets. There is no need to wait to see what happens in California.¹⁷

Regarding TANC's claim that evidence of *intentional* improper scheduling is required, TANC's statement is not correct; the problematic incentives the CAISO is attempting to avoid in the IBAA proposal can exist without intentional misrepresentation of the location of a resource.

Dr. Hildebrandt states that:

. . . as described above, LMPs established under this proposal would create an incentive for participants to misrepresent the actual location of the marginal resource(s) supporting the scheduled transaction. *Moreover, even if participants did not intentionally misrepresent the actual location of the resources supporting intertie schedules or create "circular" import and export schedules, differences in LMPs for these different sub-hubs would create a definite incentive for bilateral trading between different participants that would have the same end result.*¹⁸

The CAISO has demonstrated that: (i) there is a need for the IBAA proposal, (ii) there is a need to continue to monitor the success of proxy bus mechanisms in use, and (iii) there is a need to allow for the evolution of such mechanisms in addressing inappropriate scheduling incentives. Indeed, if there were any doubt about these needs or the opinions of Dr. Hildebrandt, Dr. Harvey, and the CAISO's Market Surveillance Committee regarding these needs, it should

¹⁶ *Id.*

¹⁷ *Id.* at 7.

¹⁸ Exhibit ISO-2, Testimony of Dr. Hildebrandt, at 10-11 (emphasis added).

be dispelled by the recent filing of the New York Independent System Operator (“NYISO”) in Docket No. ER08-1281-000.

The NYISO has successfully used proxy bus mechanisms during its operation and it initially had four proxy buses – one each for modeling interchange transactions with the ISO-New England (“ISO-NE”), the Ontario Independent Electric System Operator (“Ontario IESO”), the PJM Interconnection LLC (“PJM”), and Hydro Quebec.¹⁹ Nonetheless, despite the past success of the proxy bus mechanisms with regard to the scheduling and pricing of interchange transactions with other BAAs (and because of the issues that arise with multiple pricing points as identified by Dr. Harvey and Dr. Hildebrandt²⁰), the NYISO recently filed to obtain new authority to preclude the scheduling of certain external transactions (imports, exports, and wheel-throughs).²¹ The NYISO describes the issue as “a relatively small number of market participants . . . scheduling transactions over circuitous Scheduling Paths around Lake Erie to take advantage of a ‘seam’ between the methods that are used by the organized markets in the Eastern Interconnection to price External Transactions.”²² The NYISO’s filing represents a specific instance of the scheduling incentives discussed in the June 17 Filing. The filing confirms one of the fundamental points made by Dr. Hildebrandt and Dr. Harvey and that is – if presented with alternative scheduling points, market participants will schedule in a less direct manner if it results in more favorable pricing.

¹⁹ Exhibit ISO-3, Testimony of Dr. Harvey at 31-32.

²⁰ See, e.g., Exhibit ISO-3, Testimony of Dr. Harvey at 6-7, and 18-20; Exhibit ISO-2, Testimony of Dr. Hildebrandt at 8-9.

²¹ See the NYISO’s filing in Docket No. ER08-1281-000 at 3-4 (describing 8 sets of scheduling activity over 8 paths).

²² *Id.* at 2.

In summary, contrary to the arguments of SMUD, TANC, and SVP that the IBAA proposal is not needed, the June 17 Filing fully demonstrates the need for the IBAA proposal.²³ Moreover, the experience of the eastern ISOs and RTOs (including the recent NYISO filing) makes clear that the issues with the use of LMP pricing and interchange transactions are not “theoretical.” In response to the June 17 Filing, SMUD and TANC (and the other protestors) have not demonstrated that California’s experience is likely to be any different regarding the use of LMP pricing and the scheduling of interchange transactions.

2. The Need for Commission Action on the IBAA Proposal

As noted above, TANC, SMUD and TID argue that the CAISO has not demonstrated that there is a need for the Commission to act on the IBAA proposal because the CAISO is not ready for MRTU implementation.²⁴ The CAISO answered these allegations in the July 23 Answer.

The CAISO stated that it:

needs a final Commission determination on the IBAA proposal so that the CAISO can finalize the implementation details and Market Participants can fully test the new modeling and pricing features prior to MRTU implementation. *Regardless of when MRTU is implemented, the CAISO requires final Commission approval of the proposal in order to finalize, test, and implement the proposal in accordance with the very criteria TANC and other Market Participants cite to and have requested the CAISO follow.* For example, WAPA states that the CAISO’s IBAA proposal is not ready to be deployed and that the CAISO has not created an adequately controlled and test environment during its market simulation activities to allow market participants to test, analyze, evaluate, and confirm that their systems and rights are accurately modeled and verified because “the current market simulation testing environment does not even include the CAISO’s IBAA proposal.” WAPA at 13-14. This is precisely the point. Unless the CAISO is permitted to make the necessary market enhancements at this time, there will

²³ Contrary to its Answer to Answer at 6 (item 12) SVP has not demonstrated that the issues to be addressed by the IBAA proposal are “unlikely” to occur.

²⁴ TANC Answer to Answer at 9 (P 19); SMUD-TID Answer to Answer at 2, 4-5 (citing to the Protest of West Connect at 2-3).

always be complaints that the IBAA has not been approved, by the Commission, incorporated into the market design, and properly tested to be used to ensure rational market outcomes and reasonable prices.²⁵

Regarding the date by which the CAISO needs Commission action on the IBAA proposal, the CAISO notes that the date has changed due to a change in the projected start date for MRTU. The CAISO recently has determined that a 2008 Fall start for MRTU is not feasible.²⁶ At this time the CAISO has not yet announced a new projected start date for MRTU, but it is certain that MRTU will not go live in 2008. At the July Board of Governors meeting, stakeholders requested that the CAISO factor in three months of stability of the market systems prior to the start of MRTU. The CAISO is continuing to actively and vigorously resolve MRTU implementation issues and is working to be prepared to provide the three month system stability sought by participants. As previously stated, it takes about six weeks to implement changes to the FNM and successfully launch the FNM into the market environment.²⁷ In light of these circumstances, the date by which Commission action is needed on the IBAA proposal is now September 26, 2008.

The CAISO reiterates that even though the MRTU Fall 2008 start is delayed it still requires that amount of time to implement changes to the FNM and successfully launch the changed FNM into market simulation. As the CAISO works towards its goal to be prepared to provide market participants with three months stability as soon as possible, the CAISO believes

²⁵ July 23 Answer at 23-24 (emphasis added).

²⁶ See the August 2008 Status Report of the California Independent System Operator Corporation filed in Commission Docket No. ER06-615 at 2.

²⁷ See Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 45.

that an order by September 26, 2008 would better enable the CAISO to provide such stability as of November 1, 2008.²⁸

The CAISO has also previously informed the Commission that it has already initiated its annual process for the release of CRRs for the 2009 annual period. The CAISO initially requested issuance of a decision on the IBAA proposal 60 days after the CAISO's filing, so that CRR Holders of previously-released CRRs may have an opportunity to elect to reconfigure their previously-released CRRs prior to the start of the next annual CRR release process to be conducted later this summer. The reconfiguration of previously-released CRRs is an early step in the annual CRR process, and the CAISO is now in the process of inviting requests for reconfiguration. As the annual CRR process progresses further, Load Serving Entities will request CRR allocations through a three-tier process. It is anticipated that participants will nominate CRRs based on what their expected exposure to congestion will be. As a result, the CAISO has indicated its intent to coordinate IBAA changes with the annual CRR process, which is codified in the CAISO's proposed addition of tariff Section 36.14.1. The IBAA as filed provides for a certain pricing and modeling construct that if altered by the Commission's order may also change their expectations about which CRRs they should request in the CRR allocation and bid in the CRR auction. Therefore, the CAISO had previously requested an order by August 18 to provide participants with more certainty over what IBAA construct they should consider in their nominations. While the CAISO recognizes that a decision this early is unlikely after the recent filing of responses by the CAISO and other parties, substantial delays in issuance of the

²⁸ Six weeks from September 26, 2008 is November 7, 2008 and there are twelve weeks between November 7, 2008 and February 1, 2009 which allows for three months of market simulation testing.

decision on the CAISO's IBAA proposal beyond September 26, 2008 would compound the uncertainty of market participants as to which CRRs they will nominate.

B. TANC's Answer Indicates that There Is No Conflict Between The IBAA Proposal and the Amended OCOA

TANC asserts that the CAISO fails to honor the Amended Owners Coordinated Operation Agreement ("Amended OCOA") and the California-Oregon Intertie Path Operating Agreement ("COI POA").²⁹ The answer filed by TANC is important because of TANC's concession (or acknowledgement) regarding the operation of the Amended OCOA. As TANC's Answer makes clear, there is no conflict between the IBAA proposal and the Amended OCOA.

TANC states that:

The important point the ISO misses in interpreting section 8.4 of the Amended OCOA is that while section 8.4 does not bar charges for service a Party provides to another Party over its portion of the three-line system, it does, however, bar charges based upon flows over the three-line system *when a Party uses its own portion of the California-Oregon Intertie*. Providing transmission service to another Party, contrary to the ISO assertion, does not permit charges for *parallel or unscheduled flows* over the three-line system associated with a Party's use of its own facility. That, however, is precisely what the ISO has engineered in proposing a Captain Jack default price for schedules on the COTP that also require ISO transmission from Tracy to the load.³⁰

As emphasized by the CAISO in the July 23 Answer, the provision in the Amended OCOA regarding a Party not being charged a rate for power that flows over the System in Section 8.4 only concerns *each Party's use of its own facilities*.³¹ The CAISO also noted that the provision

²⁹ TANC Answer to Answer at 6-9.

³⁰ TANC Answer to Answer at 7 (P 14) (emphasis in original deleted; other emphases added).

³¹ *See, e.g.*, July 23 Answer at 58.

in section 8.4 concerns itself with the *unscheduled parallel flows* associated with a Party's use of its own facilities.³²

In the above-quoted passage, TANC acknowledges both points – section 8.4 of the Amended OCOA deals with *each Party's use of its own system and not being charged for the unscheduled, parallel flows* on the facilities of other Party's associated with a Party's use of own facilities. As the indicated in the Transmittal Letter to the June 17 Filing, the Panel Testimony of Mr. Rothleder and Dr. Price, and the July 23 Answer, the CAISO will charge for *scheduled flows*, not unscheduled flows under the MRTU Tariff.³³ Unscheduled or parallel flows are accounted for in real time. In addition, as the CAISO has emphasized, the IBAA proposal is only concerned with service over the CAISO Controlled Grid, it has nothing to do with an entities' scheduled use of, or the parallel flow affects associated with service over, the COTP.³⁴

In short, the IBAA proposal deals with *scheduled flows* and service over the *CAISO Controlled Grid* while the provision in Section 8.4 of the Amended OCOA, as acknowledged by TANC, deals with *unscheduled, parallel flows* and *service over the COTP* (*i.e.*, TANC's or another COTP participant's use of its own facilities under the Amended OCOA). There is no conflict between the IBAA proposal and the Amended OCOA and the CAISO respectfully requests that the Commission reject the claims to the contrary.³⁵ The CAISO applies no charge

³² See, e.g., July 23 Answer at 65-66 (quoting the description of the Amended OCOA by TANC witness Griess).

³³ See June 17 Filing at 50; Exhibit ISO -1, Testimony of Mr. Rothleder and Dr. Price at 68-70; and July 23 Answer at 57-58.

³⁴ See, e.g., July 23 Answer at 58, 59-60, 60, and 67-69.

³⁵ The CAISO's discussion herein and in the July 23 Answer and the June 17 Filing address item number 7 on page 5 of SVP's Answer to Answer. Neither SVP's Protest at 27-28; SVP-2 at 26-28; or SVP's Answer to Answer at 19-20 mention any provisions of the agreements that the IBAA proposal is purportedly to violate.

or rate to either the transmission service over the COTP (or “COTP schedules”) or on the parallel flow effects on the PACI-P facilities of transmission service over the COTP; it is not doing either of these activities today under the existing CAISO Tariff and it will not do either of these activities under the MRTU Tariff.³⁶

It also is important to recognize that the IBAA Entities mischaracterize the IBAA filing in order to claim that the filing concerns itself with “unscheduled flows” which the IBAA Entities claim means parallel flow or loop flow. The purpose of the IBAA proposal does not have anything to do with managing loop flow. The IBAA Entities purposefully misuse the term “unscheduled flow” to buttress their arguments that: (i) the IBAA proposal violates contractual obligations, and (ii) the IBAA issues would be better addressed in other forums.³⁷ To be clear, it is undoubtedly true that “unscheduled flow” is an accurate description of parallel flow or loop flow and loop flow is often cited as the part of the reason for differences between scheduled flows and actual flows. However, as indicated in the June 17 Filing, the IBAA proposal is not intended to address the differences between scheduled flows and actual flows as a result of loop flow. Rather, the differences between scheduled flows and actual flows that the IBAA proposal is intended to address or limit is the difference due to the scheduling incentive to chase prices if multiple pricing points are used for interchange transactions. If a market participant schedules an interchange transaction at one location to obtain favorable pricing but dispatches generation from a different location far removed from the scheduled location, the estimated scheduled flows

³⁶ As noted by the CAISO, if the rates charged and services do not involve: (i) transmission service over a Party’s own facilities *and* (ii) an attempt to charge a rate for the parallel flow affects of a Party’s use of its own facilities, there is no violation of the OCOA. July 23 Answer at 58. These are the elements that must be established to demonstrate a violation of Section 8.4 of the Amended OCOA and TANC has proven neither. *See, e.g.*, July 23 Answer at 69.

³⁷ *See* Section III.E.2 of this pleading, *infra*.

in the day-ahead market will be inaccurate as compared to the dispatched flows in real time. In other words, the primary purpose of the IBAA proposal is to avoid inaccurate identification of congestion in the day-ahead market and to avoid the pricing consequences of such errors; its purpose is not to manage unscheduled parallel flow.

1. CAISO Statements Regarding a Collateral Attack on LMP Pricing

The inappropriateness of the contractual arguments, in part, forms the basis for the CAISO's belief that protestors' allegations amount to a collateral attack on the use of LMP pricing under MRTU. In other words, once one recognizes that there are no contractual violations, the arguments of TANC and others are simply an objection to the use or placement of a virtual resources at an external locations in the Full Network Model in order to better assess the impacts on the CAISO Controlled Grid of interchange transactions that use the CAISO Controlled Grid.³⁸ As noted in the testimony of Dr. Harvey, the use of virtual resources placed at external locations in a network model to better assess the impact of interchange transactions is something that has successfully been in use for years by the ISOs and RTOs in the east.³⁹ Importantly, the external location of a virtual resource in a network model that is used solely for the purpose of assessing the impact of interchange transactions on a transmission system (in this case, the CAISO Controlled Grid) has no affect on the transmission service over, or the

³⁸ See, e.g., MID Answer to Answer at 4 (P 7) and SMUD Answer to Answer at 6. For example, SMUD states that the CAISO's proposal "does *not* place virtual System Resources at external locations in the Full Network Model based on the best available information in the CAISO's possession." SMUD Answer to Answer at 6 (citing to the July 23 Answer at 70). SMUD claims "[o]n the contrary, [the IBAA proposal] assumes that *all* of the power sold from the SMUD-TID BAA into the CAISO markets is sourced in the Pacific Northwest even though it has stated it *knows* this assumption is flatly untrue. Yet the CAISO Motion never addresses, much less refutes or disavows this fact." *Id.*

³⁹ Exhibit ISO-3, Testimony of Dr. Harvey at 31-40.

management of congestion on, the external transmission system (in this case, the non-CAISO Controlled Grid transmission facilities within the SMUD and TID BAAs).

The CAISO has emphasized that notwithstanding the placement of virtual resources in the Full Network Model at external network locations (to better reflect the location of the external resources actually used to implement the interchange transactions); the CAISO will not manage congestion on, or charge for losses over, the transmission facilities within the IBAA under the IBAA proposal.⁴⁰ The transmission service over and any constraints within the IBAA systems are scheduled, priced and managed by the transmission system operators within the IBAA (*i.e.*, the transmission operators within the SMUD and TID BAAs). Dr. Harvey explains that:

[w]ith MRTU's use of LMP pricing, the calculated congestion impacts are used to determine LMPs and congestion charges on the CAISO Controlled Grid, including the LMPs and congestion charges calculated and applied to import and export transactions. It is important to clearly understand that while the location of the proxy bus (or buses) in the CAISO's Full Network Model is within the SMUD-TID IBAA and external to the CAISO Controlled Grid (indeed its very purpose is to more closely approximate the location of the resources within the SMUD-TID IBAA whose output is adjusted to support interchange transactions with the CAISO), the LMPs calculated using the proxy bus are applied only to transactions sourcing or sinking on the CAISO Controlled Grid. In other words, the proxy bus mechanism establishes prices to be used in connection with use of the CAISO Controlled Grid, the proxy bus prices are not applied to transmission service over any non-CAISO Controlled Grid facilities.⁴¹

The IBAA Entities presume they have an entitlement to an LMP modeled at Tracy (as opposed to being modeled at Captain Jack or at the location of the external resources pursuant to a non-default modeling and pricing agreement). There was (and is) no such entitlement, the

⁴⁰ See Transmittal Letter to June 17 Filing at 22 and Exhibit ISO-3, Testimony of Dr. Harvey, at 20-21.

⁴¹ Exhibit ISO-3, Testimony of Dr. Harvey, at 21 (emphasis added).

CAISO has long indicated that under MRTU radial modeling is not acceptable for the IBAA (formerly adjacent and embedded control areas). The IBAA Entities continue to allege but have not demonstrated that the placement of a virtual resource in the Full Network Model at external network location (*i.e.*, Captain Jack) is the same as the CAISO managing congestion on, or charging for losses over, the COTP. Nor have the IBAA Entities demonstrated that the difference in the LMPs applicable to imports at Tracy (*i.e.*, the difference between a Tracy LMP modeled in a radial manner with a resource at the Tracy Intertie Scheduling Point and a Tracy LMP modeled with a virtual resource at located at Captain Jack) is a harm to the IBAA Entities. In other words, in all the material filed by the IBAA Entities collectively the Commission will find no authority or citation supporting the principle that an LMP modeled in a radial manner at Tracy is an entitlement of the IBAA Entities that is being abridged by the IBAA proposal; the reason is because there is no such entitlement or right.⁴²

SMUD notes the proposed use of a single proxy bus pricing point for imports at the Captain Jack Substation and criticizes the modeling inaccuracies attendant with the approach.⁴³ SMUD then claims that the CAISO “never addresses” the inaccuracies associated with the assumptions of a single proxy buses.⁴⁴ SMUD’s claim is incorrect. The issue mentioned by SMUD is one of the issues associated with the CAISO’s move from a multiple hub proxy bus approach to a single hub proxy bus approach and the issue was discussed, e.g., in various CAISO discussion papers in the development of the single hub proxy bus proposal; in the Transmittal

⁴² The CAISO notes that the forgoing discussion and the discussion of these points in the July 23 Answer and throughout the June 17 Filing address item numbers 5, 8, 9, 10 and 11 on pages 5-6 of SVP’s Answer to Answer. SVP *will receive* an LMP applied to schedules using the CAISO Controlled Grid at Tracy.

⁴³ SMUD Answer to Answer at 6.

⁴⁴ *Id.*

Letter to the June 17 Filing;⁴⁵ in the testimony of Dr. Hildebrandt;⁴⁶ in the panel testimony of Mr. Rothleder and Dr. Price;⁴⁷ and in the testimony of Dr. Harvey.⁴⁸ The issue, in particular, was fully vetted by Dr. Harvey who states that:

. . . except in the case of radially connected dispatch regions, no single proxy bus location will provide a perfect representation, under all conditions, of the changes in line flows associated with a change in scheduled net interchange with that balancing authority area. The location of the proxy bus in any single proxy bus pricing system is therefore necessarily a compromise that will not be ideal over all system conditions. There are, however, a number of elements of flexibility within a single proxy bus pricing system can be utilized to better approximate the actual system impacts of changes in scheduled net interchange.

The choice of a single versus multiple proxy bus location for scheduling interbalancing authority area transactions is an often misunderstood element of electricity market design. While it might seem that the introduction of multiple proxy buses that allows market participants to choose the proxy bus used to schedule their transactions might provide a better approximation of system impacts than a single proxy bus model, this is not the case; in fact, just the reverse will generally be the case. It is seen that such a multiple proxy bus design will likely provide market participants with financial incentives to schedule transactions such that the proxy bus used to schedule their transactions does not reflect the actual location of the generation that would be dispatched to support the transaction. Moreover, this effect is systematic, causing a system operator employing a multiple proxy bus system to price scheduled net interchange in a manner that incurs costs that must be recovered from market participants in uplift charges. Despite the approximations inherent in a single proxy bus system, no more than one proxy bus should be established to price a single interchange schedule with an adjacent balancing authority area.⁴⁹

Dr. Harvey summarized the issue stating that:

⁴⁵ Transmittal Letter to the June 17 Filing at 20-21.

⁴⁶ Exhibit ISO-2, Testimony of Dr. Hildebrandt at 1-22. *See, e.g.*, Exhibit ISO-2 at 8 (where Dr. Hildebrandt notes that the potential congestion management benefits of the sub hub approach depend *entirely* on having an accurate representation of the marginal System Resource (*e.g.*, SMUD Hub, Western Hub, Captain Jack, etc.) actually supporting the import and export schedule and bids submitted by Market Participants).

⁴⁷ Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 54-58.

⁴⁸ *See, e.g.*, Exhibit ISO-3, Testimony of Dr. Harvey, at 13.

⁴⁹ Exhibit ISO-4, Scott Harvey, "Proxy Buses and Congestion Pricing of Inter-Balancing Authority Area Transactions" June 9, 2008 at 8.

There is no single proxy bus location that will be ideal from the standpoint of modeling the impact of changes in scheduled interchange on transmission congestion over all hours of the year and over all system conditions. It will be necessary to choose a proxy bus that provides the best approximation of actual system impacts under likely system conditions. It will be difficult to assess *ex ante* the best location for a proxy bus and the ideal location may change over time with changes in the generation mix in external regions, changes in dispatch and transmission scheduling practices in the adjacent balancing authority area, and changes in market participant behavior. The location of a proxy bus may need to be modified over time based on operating experience to reflect these kinds of changes in the operational environment.⁵⁰

The essence of the arguments of TANC, SVP, SMUD and others is to: (i) simply acknowledge how single proxy bus mechanisms work, *i.e.*, to note that no single proxy bus will be accurate (paraphrasing Dr. Harvey) in all hours of the year and over all system conditions;⁵¹ and (ii) ignore that the CAISO has proposed using the default pricing points only in the absence of better information from an entity engaging in an interchange transaction that would allow the CAISO to verify that entity acted in accord with its schedule.

It also is important to recognize that the CAISO's proposal is more reasonable than the method described in the protests of TANC, SMUD, TID, Western, SVP and others, which is to model each Intertie Scheduling Point in a radial manner and establish LMPs for each Intertie Scheduling Point based on the radial modeling. While the two default pricing points under the single hub proposal won't reflect accurate modeling in all circumstances, they will correctly reflect the location of the approximate source or sink supporting external transactions in a number of circumstances. In contrast, the approach favored by the municipal community (*i.e.*,

⁵⁰ *Id.* at 2-3.

⁵¹ *See, e.g.*, TANC Answer to Answer at 8 (P 17).

radial modeling at multiple pricing points) would be inaccurate more often than the CAISO's single hub approach and it would not address pricing issues.

Stated differently, it is important to recognize that some import transactions from the proposed IBAA in fact will use the COTP to deliver the energy to the CAISO Controlled Grid and that the location of the external resources actually used to implement these transactions will be such that it in fact is reasonable to consider the Captain Jack Substation as the source of the transactions. Modeling the source of (and establishing LMPs for service over the CAISO Controlled Grid associated with) such import transactions by placing a virtual resource at the Captain Jack Substation is *more appropriate* than the radial modeling and pricing the transactions at the Tracy 500 kV Interconnection.⁵² In these circumstances, TANC, SMUD, and the other entities objecting to the IBAA proposal, want the CAISO to ignore the location of the source of the import and model the transaction using a fictional resource located at the Tracy Intertie Scheduling Point⁵³ which the CAISO knows always will be inaccurate because there is no generating resource or load served at the Tracy 500kV interconnection point.⁵⁴ Modeling and pricing transactions in this manner (*i.e.*, at the Tracy 500kV interconnection point) will value or pay entities for such imports as if they relieve north-to-south congestion when they would in fact be exacerbating such congestion because the true location of the resource is in the north.⁵⁵ In the absence of better information, the CAISO must make reasonable assumptions or approximations

⁵² See Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 63-67; Exhibit ISO-3, Testimony of Dr. Harvey at 18-20; and the Transmittal Letter to June 17 Filing at 45-46.

⁵³ See, *e.g.*, TANC Answer to Answer at 7-8 (P 16); and SVP Answer to Answer at 5 (item 8 citing to SVP Protest at 28-29) and 6 (item 11 citing to SVP Protest at 34-35).

⁵⁴ See Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 63-67.

⁵⁵ See Exhibit ISO-2, Testimony of Dr. Hildebrandt, at 9.

regarding the location of the resources supporting interchange transactions between the SMUD-TID IBAA and the CAISO.⁵⁶

2. The CAISO Did Not Sandbag SMUD Regarding Claims that the IBAA Proposal Violates Certain Contracts

SMUD argues that the CAISO's response to the allegations that the IBAA proposal violates various contracts is inappropriate because the CAISO improperly chose "to wait until filing an answer to protests to present its arguments, after giving the issue only cursory treatment in its actual Section 205 filing" and that "the Commission should not entertain consideration of arguments that should have been included in the CAISO's filing."⁵⁷ SMUD states that the CAISO "should not be rewarded for such tactics by having its arguments considered."⁵⁸ The CAISO did not sandbag SMUD regarding the allegations that the IBAA proposal violates certain contracts.⁵⁹

Prior to the filing of comments by SMUD and others on July 8, 2008, the main written indication of the specific contractual arguments was two bullet points in a March 6, 2008 power point presentation by TANC.⁶⁰ Moreover, as noted by the CAISO in the Transmittal Letter, in the direct discussions between the CAISO and IBAA Entities (both after the issuance of the

⁵⁶ See, e.g., Transmittal Letter to June 17 Filing at 32-33; and Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 60-61 (indicating that absent information that verifies the location and dispatch of the external resources used to implement an import transaction, the CAISO believes that the Captain Jack System Resource represents a reasonable approximation of the marginal resources likely to be used to support the scheduled interchange transaction).

⁵⁷ SMUD Answer to Answer at 3; see also SMUD Answer to Answer at 13-14.

⁵⁸ *Id.* at 13.

⁵⁹ See Transmittal Letter to June 17 Filing at 50-53.

⁶⁰ See the March 6, 2008 Power Point Proposal of TANC: "Implications of the CAISO's IBAA Proposal on the California-Oregon Transmission Project" at 3 (third bullet) and 6 (third bullet) (hereinafter: "March 6, 2008 TANC Power Point Presentation"). The *March 6, 2008 TANC Power Point Presentation* can be found at <http://www.caiso.com/1f82/1f82854699b0.pdf>.

April 18, 2008 Draft Final IBAA Proposal and during the discussions on the May 8, 2008 proposal by the IBAA Entities), the statements by the IBAA Entities regarding the OCOA and the other agreements changed.⁶¹ To the extent the alleged contractual issues were discussed, the vernacular used was that the IBAA proposal violated the “the spirit” of the OCOA as opposed to its literal provisions.⁶² Indeed, the CAISO was not sure at the time of filing whether the IBAA Entities were continuing to assert violations of the OCOA and other agreements.⁶³

Nonetheless, in the June 17 Filing the CAISO addressed the two contracts specifically cited in the single bullet point in TANC’s March 6, 2008 power point presentation and its discussion was not cursory. Furthermore, prior to filing the IBAA proposal, the CAISO reviewed its Interconnected Control Area Operating Agreement (“ICAOA”) with SMUD and the CAISO’s Operating Agreement (“OA”) with the City and County of San Francisco (“CCSF”) and did not find an inconsistency between those agreements and the IBAA proposal. The CAISO was (and is) committed to honoring all of its agreements and it did not know the specific concerns with those agreements until the protests were filed on July 8, 2008.⁶⁴ For all of the above reasons, the CAISO respectfully requests that the Commission reject SMUD’s allegation that the CAISO should have been included more detail in the June 17 Filing regarding the contractual claims.

⁶¹ See Transmittal Letter to the June 17 Filing at 51.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ In developing the IBAA proposal, the CAISO had answered questions put to it by CCSF regarding the OA. See the CAISO’s response to stakeholder questions dated February 5, 2008 at 15-18. These responses can be found at <http://www.caiso.com/1f5e/1f5e90ac6f20.pdf>.

3. The IBAA Proposal Does Not Violate Section 8.4 of the COI POA as Alleged by MID

MID states that one of its arguments is uncontested by the CAISO.⁶⁵ MID's claim is that the IBAA proposal violates section 8.4 of the California-Oregon Intertie Path Operating Agreement ("COI POA"). MID's argument is misplaced, the IBAA proposal has nothing to do with Section 8.4 of the COI POA.

Section 8.4 of the COI POA involves the compensation paid to the Path Operator for the COI for its services, specifically: "[t]he Owners shall compensate the Path Operator for COI for services provided pursuant to Section 8.3 of this Agreement in accordance with the costs specified in Appendix B of this Agreement."⁶⁶ Appendix B sets forth annual costs incurred by the Path Operator and the compensation to be paid by each owner of the COI. In its protest, MID stated that the issue it was raising was premised on "the extent [to which] the CAISO considers the IBAA proposal to entail compensation for its Path Operator duties."

The CAISO clarifies that the IBAA proposal does not entail compensation for the CAISO's duties as Path Operator. Compensation for the CAISO's duties as Path Operator is governed by Appendix B to the COI POA. The IBAA proposal does not conflict with Section 8.4 of the COI POA.

C. The IBAA Proposal Does Not Create Phantom Congestion and Reliability Issues

MID claims that there is a disincentive for energy providers located north of Captain Jack to use the California Oregon Transmission Project ("COTP"). Specifically, MID states that a:

⁶⁵ MID Answer to Answer at 6 (P 10).

⁶⁶ COI POA § 8.4.

seller would have to pay the double-charges of congestion and losses that the CAISO seeks to impose, in addition to losses and fees charged by the California-Oregon Transmission Project (“COTP”) owners, that the seller would not have to pay using CAISO transmission at Malin. Both of those issues combined create disincentives to use COTP transmission. These disincentives create the “phantom congestion” and reliability issues that MID identified in its Protest.⁶⁷

First, as noted earlier, the CAISO has responded to the arguments regarding double charging for congestion and losses. The IBAA proposal is only concerned with service over the CAISO Controlled Grid, the CAISO will not manage congestion on, or charge for losses over, the transmission facilities within the IBAA.⁶⁸

Second, MID’s statement that the alleged disincentives create phantom congestion and reliability issues is an attempt to demonstrate that the IBAA proposal will create the very “phantom congestion and reliability issues” that the IBAA proposal seeks to avoid. MID’s statements are in error because they confuse *actual congestion accurately identified* and resolved in the day-ahead market with the *inaccurate identification of congestion* in the day-ahead market that the IBAA proposal seeks to avoid. For example MID states:

The CAISO will rely more heavily on the CAISO Controlled Grid portion of the COI as market participants gravitate that way, given the pricing incentives. Market participants will leave capacity unused on the COTP. This behavior will lead to congestion on the CAISO-Controlled Grid starting at Malin, when that congestion is not necessary. *This is effectively what has been called “phantom congestion.”*

* * * *

If the CAISO finds imports on CAISO-Controlled Grid transmission to be overly congested, due to the pricing incentives the CAISO is providing here, *the CAISO may be left with scrambling to redispatch resources in real-time.*⁶⁹

⁶⁷ MID Answer to Answer at 4 (P 6).

⁶⁸ See, e.g., Transmittal Letter to June 17 Filing at 22-23 (including n.66) 47-48, and 49-50; Exhibit ISO-1, Testimony of Mr. Rothleder and Dr. Price at 74-79; Exhibit ISO-3, Testimony of Dr. Harvey, at 20-21; and, July 23 Answer at 36-37.

⁶⁹ MID Answer to Answer at 13 (P 30 and P 32) (emphases added).

MID's use of the term phantom congestion is in error. The scenario postulated by MID does not involve the inaccurate identification of congestion in the day-ahead market. MID postulates differences in the behavior of market participants that (it asserts) will lead to more *actual* congestion on the CAISO Controlled Grid in the day-ahead market. Even if MID's assertion turns out to be true (which the CAISO does not concede), the congestion will be accurately identified and resolved in the day-ahead market which is one of the central goals of MRTU and the reliance on LMPs. The CAISO reiterates that the reliability benefits of the IBAA proposal come from ensuring that there are not significant differences between scheduled, day-ahead flows and actual, flows in real time.⁷⁰

The CAISO explained in the June 17 Filing that without the IBAA proposal the scheduling incentives can lead to differences between the location of the resources identified in the day-ahead schedule to implement interchange transactions and the actual location of the resources dispatched in real time to implement interchange transactions.⁷¹ The effect of these scheduling incentives is the inaccurate identification of congestion in the day-ahead market that is not consistent with the congestion experienced in real time. The inaccurate identification of congestion in the day-ahead market can take two different forms both of which can impact reliability by having the CAISO grid operators scramble in real-time.⁷² The two different forms of inaccurate identification of congestion in the day-ahead market are “phantom congestion” (*i.e.*, congestion modeled in the Day-Ahead Market that is not present in real-time) and its

⁷⁰ See Transmittal Letter to June 17 Filing at 8-9 (“Reliability Benefits of the IBAA Proposal”).

⁷¹ *Id.* at 3, 4, 9-11, 18, 20 (including nn.54 and 56), 21, and 43-44.

⁷² *Id.* at 11 (quoting the *September 2006 Order*), 12 (and n. 31), and 42.

corollary (*i.e.*, congestion not modeled or masked in the Day-Ahead Market that is present in real-time).⁷³

The behavior and scenario postulated by MID is not phantom congestion; it does not involve the inaccurate identification of congestion in the day-ahead market. In addition, MID does not claim that the alleged greater use of the CAISO Controlled Grid (even if it were to occur) would be inaccurately identified in the day-ahead market.⁷⁴ Therefore, the CAISO respectfully asks that the Commission reject MID's allegation that implementing the IBAA proposal will create phantom congestion and reliability issues.

D. Arguments that the IBAA Proposal Is Unduly Discriminatory

1. MID's Arguments

MID asserts that the IBAA proposal is unduly discriminatory because the SMUD and TID BAAs are similarly situated with other BAAs.⁷⁵ The CAISO has addressed these arguments.⁷⁶ MID also claims the CAISO has not addressed the "disincentive for imports from the SMUD/WAPA/TID BAAs" citing to the July 23 Answer at 33-34. The CAISO's response to these allegations in the July 23 Answer includes the material at 30-33.

2. SMUD's Arguments

⁷³ *Id.* at 41-42. *See also* Exhibit ISO-3, Testimony of Dr. Harvey, at 19.

⁷⁴ As noted by the CAISO, it does not agree that the IBAA proposal will devalue the COTP or is a disincentive to use of the COTP. *See* Transmittal Letter to the June 17 Filing at 48-49; and July 23 Answer at 30-34. *See also* Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price, at 89 (indicating that "[t]o the extent schedules/bids to use PACI rights exceed the scheduling limit on PACI, there will be no effect on the congestion component of the schedules that are using COTP. Therefore, schedules on COTP will not be affected by binding congestion on the PACI scheduling limit").

⁷⁵ MID Answer to Answer at 4-5 (P 8).

⁷⁶ *See* July 23 Answer at 40-41 (and 40-49 generally); Transmittal Letter to the June 17 Filing at 26-33; Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price, at 28-43; and Exhibit ISO-3, Testimony of Dr. Harvey, at 30-31.

SMUD claims that the CAISO's response to the claims of undue discrimination does not address its evidence that purports to contradict the CAISO's arguments.⁷⁷ The CAISO disagrees with SMUD's assertions but will not reiterate here all of the evidence contained in the June 17 Filing supporting the application of the IBAA proposal to the SMUD and TID BAAs. Rather, the CAISO specifically addresses three of SMUD's allegations in its July 29, 2008 Answer: (i) the argument regarding the size of an interconnection, (ii) the argument regarding discrepancies between scheduled and actual flows between the IBAA and CAISO BAA (and frequent flow reversals), and (iii) the argument that the CAISO did not address the rationale for treating the SMUD and TID together.

a. The Size of an Interconnection

With regard to SMUD's arguments regarding the size of an interconnection, the CAISO did address this argument in the July 23 Answer.⁷⁸ In response to SMUD's reiteration of the argument in its Answer (*i.e.*, that the CAISO did not address Mr. Alaywan's testimony regarding the size of an interconnection), the CAISO will only add here that the Tracy 500 kV Interconnection is an existing interconnection with the SMUD-TID IBAA, it is in the middle of the CAISO system, and it is a large interconnection of over 4000 MW. To quote Mr. Rothleder and Dr. Price" [t]he Tracy Intertie is unique in that it is a *high-capacity intertie* in the *middle of the CAISO Controlled Grid* at which *no physical generation is located*.⁷⁹ While SMUD's

⁷⁷ See SMUD Answer to Answer at 7-8 and 11-12.

⁷⁸ See July 23 Answer at 44 (quoting SMUD's witness and noting that the CAISO did not base its determination to apply its IBAA proposal to the SMUD and TID BAAs on the criteria of the number of interconnections "by itself"; rather, it examined several different criteria and placed those criteria in the MRTU Tariff).

⁷⁹ Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price, at 63 (emphasis added).

witness Mr. Alaywan states that one cannot make a conclusion about the impact of neighboring systems on the CAISO without knowing the size of their interconnections,⁸⁰ he certainly is aware of the presence and size of the Tracy 500 kV Interconnection between the SMUD-TID IBAA and the CAISO BAA. Moreover, the CAISO reiterates that it did not base its determination to apply its IBAA proposal to the SMUD and TID BAAs solely on the number of interconnections; rather, it examined several different criteria and placed those criteria in the MRTU Tariff.

b. The CAISO's Evidence Regarding Discrepancies Between Scheduled and Actual Flows

In its Answer, SMUD claims that the CAISO's citation to evidence regarding large and persistent discrepancies between scheduled and actual flows between the IBAA and CAISO BAA (and frequent flow reversals) does not rebut the evidence of its witness Mr. Alaywan or the evidence put forth by SVP witnesses.⁸¹ SMUD's assertion is in error. The referenced testimony of Mr. Alaywan concerns itself entirely with the CAISO's analysis performed for a week that contained the CAISO's system peak on July 24, 2006 (*i.e.*, the week of July 23, 2006 to July 30, 2006).⁸² SMUD's allegation ignores that in response to stakeholder concerns regarding the use of only a week's worth of data, the CAISO performed an analysis of an entire year's worth of data, *i.e.*, from December 1, 2006 to November 30, 2007 (*see* the twelve diagrams for all of the external BAAs with which the CAISO is interconnected in Attachment A to Exhibit ISO-1).

No where in the testimony of Mr. Alaywan or SVP's panel witnesses of Boccignone-Wright-Wangle do SMUD or SVP dispute the CAISO's analysis contained in Attachment A to

⁸⁰ Exhibit SMUD-3 at 13-14.

⁸¹ SMUD Answer to Answer at 7-8 (discussing Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price, at 21-24).

⁸² *See* Exhibit SMUD-3 at 37-44.

Exhibit ISO-1 (or Mr. Rothleder’s and Dr. Price’s discussion of that analysis). As noted above, the testimony of Mr. Alaywan cited by SMUD focuses only on the week’s worth of data discussed on pages 21-24 of Exhibit ISO-1 even though Mr. Rothleder and Dr. Price note that the: “review of data for longer time periods, *discussed later in this Testimony*, shows that the patterns presented here reflect persistent trends.”⁸³

In its Answer SMUD notes the diagrams contained in Attachment A to Exhibit ISO-1, but then erroneously asserts Mr. Alaywan’s testimony rebuts that evidence even though Mr. Alaywan never addressed the information contained in Attachment A (*i.e.*, the analysis covering an entire year). SMUD’s states:

In support of its argument that its filing is substantiated by studies, CAISO states that its “testimony goes on to show how the differences between actual and scheduled flows are a persistent problem, one that cannot be solved by merely adding external transmission to the full network model.” Answer at 99. It then adds that “Diagrams 8 and 11 of *Attachment A* show the variance between SMUD and TID’s scheduled and actual flows, which are significantly higher than those of the other external BAAs.” *Id.* at 100.

How this answer -- which does nothing but reiterate what was in the CAISO’s filing -- could add to the Commission’s understanding of the issues is completely mystifying. Worse, *it ignores the testimony of SMUD and Silicon Valley Power witnesses who directly contradict the CAISO’s conclusions*. SMUD witness Alaywan testifies without contradiction that the CAISO has made gross computational errors in summing the data and that there were, for example, no flow reversals during the period the CAISO describes. Ex. SMUD-3 at 38.⁸⁴

SMUD concludes stating that: “[t]he CAISO, moreover, cannot possibly know whether ‘the variance between SMUD’s and TID’s scheduled and actual flows are . . . significantly higher than those of other external BAAs’ because it has never made any comparison!”⁸⁵

⁸³ Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price, at 22 (emphasis added).

⁸⁴ SMUD Answer to Answer at 7 (citations in the original; emphasis added).

The CAISO respectfully asks that the Commission reject this argument – the CAISO did make the comparison SMUD mentions; its analysis in Attachment A does show the variance between SMUD and TID’s scheduled and actual flows, which are significantly higher than those of the other external BAAs; and, the evidence cited by SMUD (in Mr. Alaywan’s testimony) does not address the information in Attachment A.

In its Answer SMUD then states:

By contrast, SVP witnesses point out that if the CAISO’s concern is limiting inappropriate scheduling incentives occurring *where there are large price differentials at different interface nodes*, “*when compared to the differentials between the lowest priced and highest priced interface nodes in northern California, the southern California differentials are markedly higher.*” Ex. SVP-2 at 47-50. It is no wonder that the CAISO can claim an absence of disputed issues of material fact warranting a hearing – it just pretends they do not exist.⁸⁶

SMUD’s statement is inaccurate and a *non-sequitor*. The CAISO is not concerned with limiting “large price differentials at different interface nodes.” For example, if an entity (or entities) engaging in an interchange transaction from the SMUD-TID IBAA provides the CAISO with the ability to verify the location and dispatch of the external resources used to implement the interchange transaction, it can receive non-default pricing for the transactions *and* the CAISO is not concerned with the differential such pricing may have with the prices at other interface nodes or at the default pricing points. As reflected in the June 17 Filing, the CAISO is concerned with establishing LMPs that – as accurately as possible – reflect the actual underlying transactions, it is not concerned with limiting price differentials between interface nodes.⁸⁷

⁸⁵ SMUD Answer to Answer at 7-8

⁸⁶ *Id.* at 8.

⁸⁷ The discussion responds to item number 13 in SVP’s Answer to Answer at page 6.

c. SMUD Is Incorrect that the CAISO Failed to Address the Contention that It Is Unreasonable to Treat the SMUD and TID BAAs as a Single IBAA

In its Answer, SMUD notes the contention that it is unreasonable for the CAISO to group the TID BAA with the SMUD BAA.⁸⁸ SMUD characterizes the CAISO's response to this issue and then alleges the CAISO's argument "is completely non-responsive to TID's objection that there are no grounds for creating a *single* TID-SMUD IBAA."⁸⁹ The problem with SMUD's characterization of the issue is that SMUD mentions some of the aspects noted by the CAISO but omits a key part of the CAISO's rationale.

In addition to the fact that both SMUD and TID were once a part of the CAISO BAA, in addition to the fact that both SMUD and TID are embedded within CAISO BAA, and in addition to the fact that both SMUD and TID transmission systems run in parallel with the CAISO Controlled Grid, the SMUD BAA and the TID BAA are adjacent to one another and have an interconnection with each other.⁹⁰ As stated by Mr. Rothleder and Dr. Price:

As previously noted the TID transmission system runs in parallel with CAISO transmission system and TID is within the former PG&E and CAISO BAA. Moreover, the SMUD BAA and TID BAA have an interconnection with each other such that interchange transactions can be scheduled on a contract path between SMUD and TID without scheduling through the CAISO and that this fact creates the opportunity for a schedule from TID to the CAISO to actually be sourced from the SMUD BAA or even from the Pacific Northwest. It is for this reason that the SMUD and TID BAA must be treated as one combined IBAA.⁹¹

⁸⁸ SMUD's Answer to Answer at 12-13.

⁸⁹ *Id.* at 13 (emphasis in original).

⁹⁰ *See* July 23 Answer at 47.

⁹¹ Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price, at 33.

The CAISO respectfully requests that the Commission reject SMUD’s selective discussion of the CAISO’s support for the IBAA proposal and approve the treatment of the SMUD and TID BAAs as a single IBAA.

E. Arguments Regarding the Reliability Aspects of the IBAA Proposal, Seams Issues, and the Use of WECC as a Forum to Address IBAA Issues

1. There Is No Inconsistency Between the CAISO’s Statements Regarding the Reliability Aspects of the IBAA Proposal and the CAISO’s Statements Regarding Seams Issues

TANC claims that collaboration is necessary for the IBAA (not just an MEEA) proposal in accordance with the Commission’s Seams directives and that the CAISO is seeking to override the collaborative process ordered by the Commission.⁹² SMUD, TID, and TANC accuse the CAISO of ignoring Commission directives to work on seams issues.⁹³ The allegations of SMUD, TID, TANC and West Connect mischaracterize both the CAISO statements and the Commission’s Orders regarding seams issues and the collaborative process involving the Western Electricity Coordinating Council (“WECC”). For example, TANC accuses the CAISO of ignoring Commission directives to work on seams issues, but in the very next sentence of its Answer acknowledges that the Commission has stated that: “the need for better data exchange among control areas in the West *is not a seams issue* related to MRTU.”⁹⁴

The discussion by TANC, SMUD, and TID inappropriately merge or conflate statements regarding the reliability aspects of the IBAA proposal and statements regarding seams issues to

⁹² TANC Answer to Answer at 10-13 (PP 22-26).

⁹³ TANC Answer to Answer at 11(P 23); SMUD-TID Answer to Answer at 2, 4-5 (citing to the Protest of West Connect at 2-3).

⁹⁴ See TANC Answer to Answer at 11 (P 23) (emphasis added) and the Commission’s April 20, 2007 “Order Granting In Part and Denying in Part Requests for Clarification and Rehearing”, *California Independent System Operator Corporation*, 119 FERC ¶ 61,076 (“April 20 Order”) at P 253.

allege that the CAISO is not complying with the Commission’s directives and should be rejected by the Commission. For example, there is nothing inconsistent between the reliability needs of the IBAA proposal (*i.e.*, to ensure greater consistency between day-ahead schedules and actual, real time flows on the CAISO Controlled Grid and thereby reduce the need for CAISO grid operators to scramble in real time to resolve large differences between scheduled and actual flows)⁹⁵ and the CAISO’s statements that the IBAA proposal does not change the WECC contract path scheduling procedures or WECC interchange checkout procedures.⁹⁶

The claim by SMUD, TID and TANC that the CAISO’s answer is “internally contradictory” is in error.⁹⁷ The purported inconsistency involves the CAISO’s response to protestors’ allegations that the issues addressed by the IBAA proposal are better off addressed at the WECC and NERC. The IBAA proposal is intended to enhance reliability by reducing the difference between scheduled and actual flows that must be dealt with in real time and the CAISO supported this point in the June 17 Filing. Contrary to SMUD’s claim, the CAISO’s statements are not unsupported and are not “contradicted by the safeguards that have long been in place to ensure reliability of operations between neighboring balancing area authorities.”⁹⁸ The CAISO explained how the use of LMP pricing must apply to the pricing of interchange transactions as well as transactions internal to the CAISO Controlled Grid and that there is a significant difference between merely ensuring the delivery of *net* scheduled interchange that can

⁹⁵ See, *e.g.*, Transmittal Letter to the June 17 Filing at 8-9, and 42.

⁹⁶ See Transmittal Letter to the June 17 Filing at 23 (citing to Exhibit ISO-1, Panel Testimony of Mr. Rothleder and Dr. Price, at 72; and Exhibit ISO-3, Testimony of Dr. Harvey at 9).

⁹⁷ SMUD Answer to Answer at 9.

⁹⁸ SMUD Answer to Answer at 8.

be met using the collective resource activity at *all inertia points* versus ensuring, pricing, and validating delivery to the CAISO at a *specific location* using LMP pricing.⁹⁹

As noted in the June 17 Filing, the CAISO's desire for a more detailed exchange of data between Balancing Authorities has been consistently voiced across a number of related efforts, including: (i) the MRTU filing and the intent to include embedded and adjacent control areas (now IBAs) in the full Network Model; (ii) the attempt to resolve certain "Seams Issues" in the west per the Commission's orders; (iii) the attempt to enter into data sharing arrangements necessary to support the newly adopted mandatory NERC reliability standards; and (iv) a collaborative effort between the CAISO and other members of the now defunct Seams Steering Group – Western Interconnection ("SSG-WI") which formulated and published a conceptual proposal for coordinated day-ahead scheduling and congestion management across the entire western region.¹⁰⁰ While a better exchange of data is common to the WECC efforts to address seams issues and the IBAA proposal, the latter issue fundamentally is a modeling and pricing issue for transactions using the CAISO Controlled Grid and it is necessary to be in place at the start of MRTU; the former (*i.e.*, the WECC's efforts to address seams issues west-wide) does not involving pricing issues and obviously involves all of the BAAs within the WECC. The protection the IBAA proposal offers market participants using the CAISO Controlled Grid

⁹⁹ July 23 Answer at 9.

¹⁰⁰ Transmittal Letter to the June 17 Filing at 5.

cannot await a possible outcome in resolving west-wide seams issues and, contrary to protestors' implications, the Commission did not issue such a directive to the CAISO.¹⁰¹

2. The WECC Is Not the Proper Forum to Address IBAA Issues

NCPA and other entities intentionally skew or misstate the purposes of the IBAA proposal in order to delay implementation of the proposal by having the CAISO engage in discussions in forums that have little to do with the central purpose of the IBAA proposal. Specifically, NCPA and the other entities ignore the CAISO's primary goal to ensure customers using the CAISO Controlled Grid pay just and reasonable prices under MRTU.

For example, NCPA states that NERC/WECC should develop standards on "the type of information Balancing Area Authorities ("BAA") should provide each other *to improve modeling accuracy.*"¹⁰² NCPA continues stating that:

NERC/WECC is well equipped to handle issues associated with *accurate modeling*, and the determination of what information should be shared between BAAs to ensure effective congestion management, *which the CAISO argues is a primary basis underlying its Integrated Balancing Authority Area ("IBAA") proposal.* To the extent that the issue underlying the IBAA proposal is the accurate representation and prediction of actual flows on the system, NERC and WECC are more than competent to provide their expertise, and indeed, WECC has done much of the modeling work already. WECC and its members have worked diligently over many years to create accurate base case models of the entire WECC system, which models enable WECC and its member entities *to identify and address problems such as loop flow.*¹⁰³

Contrary to such statements, the main issue being addressed by the IBAA proposal (and the proxy bus mechanisms in use in the east) is a *pricing* issue. Specifically, the IBAA proposal is

¹⁰¹ See July 23 Answer at 114-116. See also April 20 Order at P 244, 252 and 253. Moreover, TANC, SMUD and other entities have made it abundantly clear that they are not in favor of a detailed exchange of information between BAAs and the CAISO under any circumstances.

¹⁰² NCPA Answer to Answer at 2 (emphasis added).

¹⁰³ *Id.* at 2-3 (emphases added).

concerned with: (i) the reliance on LMP pricing to ensure just and reasonable rates for service over the CAISO Controlled Grid, (ii) the incentives for inaccurate scheduling of interchange transactions to obtain favorable pricing, and (iii) the resulting inaccurate prices and unreasonable costs that can be borne by consumers due to the lack of information about the location of the external resources used to implement the interchange transactions. The logic of the argument put forth by NCPA and others is as follows:

- (1) if there were a detailed exchange of information between all BAAs in the WECC, such a system could allow for better information and management of parallel flows throughout the WECC;
- (2) if such a system of detailed information exchange between all BAAs were in place, it “could” mean (although it would by no means be certain) that each transmission operator would know the location and dispatch of external resources used to implement interchange transactions;
- (3) if each transmission operator were to know the location and dispatch of external resources used to implement interchange transactions, the issues with any one transmission operator using LMP pricing for interchange transactions would not be present; and
- (4) therefore, the CAISO, due to its reliance on LMP pricing (*i.e.*, the MRTU market design including the IBAA proposal), should work with the WECC and await the arrival of the system of detailed information exchange between all BAAs in the WECC.

These arguments are disingenuous for a number of reasons. First, as noted above, the main issue or issues being addressed by the IBAA proposal fundamentally are *pricing* issues.¹⁰⁴ Second, NCPA and others know that the WECC assiduously avoids discussing the pricing aspects of its reliability efforts in any of its forums due to the potential for antitrust violations (*i.e.*, illegal collective action or price fixing concerns). Third, the IBAA proposal has nothing to

¹⁰⁴ As noted earlier, there is nothing inconsistent about noting that the pricing and scheduling incentives can negatively affect the reliable operation of the CAISO Controlled Grid in real time if they are not addressed.

do with managing parallel flows (also referred to as loop flow). As noted elsewhere, the management of parallel flow by the CAISO under the existing CAISO Tariff is handled in real time and there will be no change in these procedures with MRTU.¹⁰⁵ The CAISO's procedures are similar to those of other BAAs.¹⁰⁶ Finally, as is made abundantly clear by the IBAA Entities themselves, they have consistently stated their opposition to having a detailed exchange of information between BAAs (and specifically the CAISO) in the west.¹⁰⁷

The CAISO notes that it does actively participate in various WECC forums and that the IBAA proposal was addressed at a meeting of the WECC Seams Issues Subcommittee ("SIS") of the WECC Market Interface Committee ("MIC") held on July 8-9, 2008 in San Mateo, California. The discussion was whether the SIS should review and evaluate the IBAA proposal. After statements by TANC and the CAISO, the other SIS members stated that since the IBAA proposal is not yet in effect and no actual adverse impacts had yet been identified, it was premature to review the proposal.¹⁰⁸ For all of the forgoing reasons, the CAISO requests that the Commission reject the arguments asking that the issues to be addressed by the IBAA proposal are better addressed by the WECC.¹⁰⁹

¹⁰⁵ See Transmittal Letter to the June 17 Filing at 50 and July 23 Answer at 58-59.

¹⁰⁶ The CAISO discussion of the IBAA proposal and its relationship to parallel flows addresses item number 6 on page 5 of SVP's Answer to Answer. There are no "detailed facts" in the material cited by SVP.

¹⁰⁷ See Transmittal Letter to the June 17 Filing at 6 (quoting the November 14, 2007 Letter from James R. Shetler, Sacramento Municipal Utility District to Charles King Vice-President of Market Development and Program Development at the CAISO), and at n.111 (referring to IBAA Entities' statements contained in Attachment E to the June 17 Filing).

¹⁰⁸ See the July 30, 2008 Quarterly Seams Report of the CAISO at 7. The report can be found at <http://www.caiso.com/2014/2014f4e325fd0.pdf>.

¹⁰⁹ See also Transmittal Letter to the June 17 Filing at 8 (quoting Dr. Harvey regarding the CAISO's long run desire for an exchange of detailed information between BAAs in the WECC: "While the CAISO pricing proposal for the SMUD-TID IBAA does not reflect the intended end state, it is an improvement over the current scheduling and

F. Issues Involving Market Efficiency and Enhancement Agreements (MEEA)

1. The Information the CAISO Requires For a MEEA Is Neither Onerous Nor Impossible to Obtain And Negotiating Such an Agreement Provides an Effective Method for Dealing with the Issues Raised by TANC and Others

TANC claims that because the ISO's default pricing proposal provides the highest benefits possible to its markets and ratepayers, the "buy low and sell high" approach would make providing a "demonstrable benefit" for purposes of executing a Market Efficiency Enhancement Agreement ("MEEA") an "impossibility".¹¹⁰ As the CAISO noted in the July 23 Answer, the provision of data that allows the CAISO to verify the location and dispatch of an external resource that is used to implement an interchange transaction is a "demonstrable benefit".¹¹¹ Such information is all that is needed to enter into an MEEA with the CAISO and allow an entity to receive non-default pricing for its interchange transactions.

Obtaining information that confirms that an entity actually used the external resource that it said it would in its day-ahead schedule hardly is an "impossibility" as alleged by TANC. To be completely clear, if such information is provided, the LMPs that the entity receives will be those LMPs established at the pricing point regardless of whether the LMPs are higher or lower than what would have been obtained had the entity not provided the information and been subject to the default LMPs. The CAISO wants entities to be paid a price that reflects the location and value of the actual external resources used to implement the transaction.

pricing mechanism, is better than the alternative proposed by the IBAA parties, and is a step forward toward the intended end state that ought to be taken." Exhibit ISO-3, Testimony of Dr. Harvey at 24-25).

¹¹⁰ TANC Answer to Answer at 26. *See also* SMUD's Answer to Answer at 14-15.

¹¹¹ July 23 Answer at 84.

NCPA states that it has significant loads located in the CAISO BAA and it “cannot stop serving them from the resources *it possesses*, wherever located” and that “[i]t also does not have the information CAISO apparently seeks nor any contractual means of obtaining it.”¹¹² NCPA deliberately ignores the CAISO’s statements regarding the information required for non-default pricing in order to assert that the information the CAISO “apparently seeks” cannot be obtained. As the CAISO has indicated several times, the information required is information that would allow the CAISO to verify that the location and dispatch of an external resource used to implement an interchange transaction is consistent with what an entity committed to do in its day-ahead schedule. The CAISO does not believe that NCPA is unaware of the location and dispatch of the resources that “it possesses” or that it does not have access to scheduling and dispatch data¹¹³

NCPA also claims that there must be an appropriate provision for the security of the information, protecting it from general disclosure.¹¹⁴ The CAISO agrees with NCPA. Dr. Harvey noted that the individual interface pricing agreements entered into by PJM include provisions for confidentiality of the information and audit rights.¹¹⁵ The CAISO anticipates that an MEEA will include comparable provisions. NCPA also states that the information requirements for an MEEA should be narrowly tailored to what is actually needed to accomplish the desired goal.¹¹⁶ The CAISO agrees with NCPA on this point as well.

¹¹² NCPA Answer to Answer at 4 (emphasis added).

¹¹³ NCPA is a certified Scheduling Coordinator (“SC”). See the July 16, 2008 list of certified SCs at <http://www.caiso.com/docs/2005/10/28/200510281214421255.pdf>.

¹¹⁴ *Id.* at 6.

¹¹⁵ Exhibit ISO-3, Testimony of Dr. Harvey at 40.

¹¹⁶ NCPA Answer to Answer at 6.

2. The Information Required to Obtain Non-Default Pricing Associated with a Market Enhancement and Efficiency Agreement

SMUD incorrectly states that the CAISO insists upon “sensitive individual day ahead data” to obtain non-default pricing.¹¹⁷ The CAISO consistently indicated that the information required is information that would allow the CAISO to verify that the location of external resources within the SMUD-TID IBAA that actually are dispatched to implement interchange transactions is consistent with the information in the day-ahead schedule.¹¹⁸ It is possible that the information required would not have to be day-ahead information but instead could be after-the-fact information made available to the CAISO. As noted by Dr. Hildebrandt, CAISO would need (and the PJM Agreements provide for) the right to audit the submitted data.¹¹⁹ Contrary to SMUD’s statement, after-the-fact data can be used for an entity to obtain non-default pricing.

It is important to recognize that the claims of TANC, NCPA, and the other IBAA Entities regarding information requirements for receiving non-default pricing (via an MEEA) simply serve to reinforce that their *only* proposed resolution of the issues is to have the CAISO model multiple pricing points in a radial manner (*i.e.*, model resources as if they are located at each Intertie Scheduling Point between the IBAA and the CAISO Controlled Grid).¹²⁰ It is one thing to object the default modeling and pricing aspects of a single proxy bus mechanism and the compromises embedded in its use (*i.e.*, the notion stated by Dr. Harvey that the location of any

¹¹⁷ SMUD Answer to Answer at 16.

¹¹⁸ *See, e.g.*, Transmittal Letter to the June 17 Filing at 10.

¹¹⁹ Exhibit ISO-2, Testimony of Dr. Hildebrandt at 17-18.

¹²⁰ *See* the Transmittal Letter to the June 17 Filing at 54 (noting that under the May 8, 2008 proposal of the IBAA Entities each interchange transaction would be modeled at the boundary points, *i.e.*, assuming the resources are located at or near the Intertie Scheduling Points themselves). The IBAA Entities refer to their proposal as the “Boundary Approach” and it can be found at <http://www.caiso.com/1fc2/1fc2d9bcd910.pdf>.

single proxy bus mechanism necessarily is a compromise that will not be ideal over all system conditions). It is quite another thing to object to *both* the default modeling and pricing aspects of the IBAA proposal *and* the available option of having more accurate non-default modeling and pricing for all entities scheduling interchange transactions from the SMUD-TID IBAA.

In other words, even though obtaining non-default modeling and pricing would solve *the vast majority of the issues* raised by the IBAA Entities regarding the default modeling and pricing points, the IBAA Entities disparage the alternative option using a variety of claims that are exaggerated at best. The question is why and the answer is because the various entities desire to engage in interchange transactions at prices calculated on the “most favorable” assumptions to the IBAA entities regarding the location of the generation supporting imports from their BAA in *all* circumstances (*i.e.*, radial modeling at multiple points), regardless of whether or not the imports are actually supported by generation whose location warrants the higher price.¹²¹

In summary, the CAISO has demonstrated that the default proposal is needed and that it is more reasonable than the boundary proposal of IBAA Entities with radial modeling at each Intertie Scheduling Point with the IBAA. The CAISO has also demonstrated that: (i) the option to obtain non-default pricing and modeling mitigates the issues an entity might have with the default proposal, and (ii) the option for non-default modeling and pricing similarly is more accurate and reasonable than the “boundary proposal” of IBAA Entities with radial modeling at each Intertie Scheduling Point with the IBAA. It is reasonable to approve the IBAA proposal for

¹²¹ See Transmittal Letter to the June 17 Filing at 7 (and material cited therein).

the start of MRTU; indeed, the CAISO has demonstrated that it would be wholly unreasonable to start MRTU without the IBAA proposal.¹²²

Moreover, as discussed in Section III.J., *infra*, the record is more than sufficient for Commission action and there is no need for hearing procedures on either the default aspects of the IBAA proposal or the option to obtain non default modeling and pricing. If the Commission desires more information on any aspect of the IBAA proposal, the CAISO respectfully asks that the Commission establish a supplemental briefing schedule to satisfy the Commission's needs and not set the IBAA proposal for hearing before an Administrative Law Judge.¹²³

Finally, as noted in the July 23 Answer, the CAISO has already agreed to discuss an alternative arrangement that would be accommodated under an MEEA with TANC and the other IBAA Entities. The CAISO will continue to pursue those negotiations and will use the Commission's Dispute Resolution Service ("DRS") to assist in the negotiations. However, these negotiations do not diminish or eliminate the need for the Commission's approval of the IBAA with the default pricing points prior to start of MRTU.¹²⁴ In addition, the CAISO does not object to the use of Settlement Judge procedures to assist in establishment of a specific MEEA agreement with any of the IBAA Entities (or any other market participant) so long as it is clear

¹²² See, e.g., Transmittal Letter to the June 17 Filing at 3 (noting that it would be unreasonable to start MRTU without such a mechanism because it would undermine a primary goal of MRTU by allowing infeasible interchange schedules to be established, causing consumers to pay inappropriate costs, and adversely affecting the real time operation of the transmission system).

¹²³ See, e.g., *FPL Energy Marcus Hook, L.P., Complainant v. PJM Interconnection, L.L.C Respondent*, 114 FERC ¶ 61,296 at PP 2, 7-9 (2006) (establishing a briefing schedule with respect to the interpretation of Section 37.2 of the PJM OATT); *California Independent System Operator Corp.*, 114 FERC ¶ 61,022 at P 20 (2006) (establishing a briefing schedule with respect to petitions for review of an arbitration award); and *Midwest Independent Transmission System Operator, Inc., PJM Interconnection, L.L.C.*, 108 FERC ¶ 61,248 at P 1 (2004) (Order Establishing Briefing Schedule and Dismissing Complaint).

¹²⁴ July 23 Answer at 116-118.

that the scope of the procedures is to develop an entity-specific MEEA and not to revisit the design or approval of the IBAA proposal.

G. Arguments that the CAISO Did Not Respond to the Alleged Risk of a Reduction in Imports with the IBAA Proposal.

SMUD claims that the CAISO did not respond to the allegation that the IBAA proposal could lead to a decrease in imports into the CAISO, thereby resulting in increased prices and decreased reliability.¹²⁵ While the CAISO did respond to these allegations,¹²⁶ SMUD claims that the risk of a reduction in imports: “was not just a problem identified by those in the SMUD and TID IBAAAs, it was a problem brought to the CAISO’s attention by its own Market Surveillance Committee (MSC).”¹²⁷ SMUD cites to the statements in its protest that:

the CAISO’s own Market Surveillance Committee (MSC) states that if the default pricing mechanism is actually implemented it will put the entire *CAISO* market at risk of reduced imports – a problem, incredibly, that it says can only be avoided if the proposal does *not* go into effect and affected BAAs instead execute agreements to turn over confidential data for the CAISO’s commercial use.”¹²⁸

SMUD’s characterization of the MSC’s statements on page 6 of its Opinion (*see* Attachment I to the June 17 Filing) is inaccurate. However, the inaccuracies pale in comparison to the more fundamental point that the MSC *supports and approves* of the IBAA proposal. On the same page of the opinion that SMUD characterizes incorrectly, the MSC states that:

We believe that the poor experience of the eastern ISOs with setting multiple pricing hubs and a single price for imports and exports, *recommends the current CAISO approach of setting different prices for imports and exports*. As the CAISO gains experience under MRTU with this IBAA pricing approach, it can

¹²⁵ SMUD Answer to Answer at 14.

¹²⁶ *See* July 23 Answer at 33-34.

¹²⁷ SMUD Answer to Answer at 14.

¹²⁸ SMUD Protest at 10-11 (citing to the MSC Opinion at 6).

consider increasing the number of pricing locations if it is granted access to the data necessary to determine with sufficient confidence the likely source of energy injected in the CAISO BAA or the sink for energy withdrawn from the CAISO BAA and if there are clear efficiency benefits of moving towards such a pricing alternative.¹²⁹

The MSC also states that in the absence of detailed information on the day-ahead schedules of all generation units and inter-ties outside of the CAISO Balancing Authority Area that exert an influence on power flows in the CAISO BAA, the CAISO's:

proposal of a single aggregate IBAA with an import and export price appears to be the best available way to obtain day-ahead schedules that are accurate predictions of real-time flows that do not involve significant monetary transfers from CAISO participants to these entities.¹³⁰

Notwithstanding the plain reading of the MSC's Opinion on the IBAA proposal, in its Answer SMUD states that the CAISO:

offers not a word in response to the problem identified in the protest – that the MSC's solution to the *conceded* import problem was to hope the proposal would never go into effect and that entities in the SMUD and TID BAAs would all execute MEEAs to bail the CAISO out.¹³¹

In short, the CAISO's response to SMUD's claim is two fold. First, SMUD's characterization and use of the MSC's opinion is inaccurate and at odds with the opinion itself. Second, the MSC does not “hope the IBAA proposal never goes into effect”, it supports the IBAA proposal.

¹²⁹ June 17 Filing, Attachment I at 6-7 (emphasis added).

¹³⁰ Transmittal Letter to the June 17 Filing at 8 (quoting the MSC's Opinion in Attachment I at 2).

¹³¹ SMUD's Answer to Answer at 14 (emphasis in the original).

H. Remaining Arguments of SVP and DOE

SVP claims that the CAISO has not responded to its argument that the LMPs under the IBAA proposal will be inaccurate because the “proposed modeling approach ignores schedules on the COTP that will deliver energy into the SMUD-Western Control Area, thus the IBAA proposal will lead to inaccurate modeling that does not realistically approximate Day Ahead actual flows.”¹³² However, the CAISO’s response to SVP’s argument was contained in SVP’s own witnesses’ testimony.¹³³

In response to a question posed to the CAISO, the CAISO noted that for transactions that are not scheduled into the CAISO system, the CAISO will not receive market nor any other information regarding the use of the COTP in the timeframe of either the CAISO’s Day-Ahead Market or Hour-Ahead Scheduling Process, which are the CAISO’s primary tools for scheduling interties in a reliable manner, and thus will not model such schedules in its market systems and applications.¹³⁴ The CAISO also noted that it will receive non-CAISO Controlled Grid COTP *aggregate net schedules* in its role as Path Operator for the California-Oregon Intertie (COI), but that information will not be input to or used by the CAISO market systems/applications because it is not available when the Day-Ahead and Hour-Ahead processes run. The CAISO would like to have all the schedules on the COTP (*i.e.*, the schedules delivering energy to, and receiving energy from, non-CAISO Controlled Grid facilities and the schedules delivering energy to, and receiving energy from, the CAISO Controlled Grid) and does not dispute the possible benefits

¹³² SVP Answer to Answer at 4 (items 1 and 2).

¹³³ See SVP-2 at 14-15, n.8.

¹³⁴ *Id.*

attendant with such data for service over the CAISO Controlled Grid under MRTU. However, SVP does not recommend that the data be provided to the CAISO. Rather, SVP states:

The CAISO can use many methods to determine *a reasonable estimate* of flows on the COTP, including: (1) *Historical COTP scheduling data, if available*, and actual historical COI flow data; (2) *Actual Malin schedules as proxy for COTP schedules* (e.g., Captain Jack schedule equals 50% of Malin schedule); or (3) *Actual COTP schedules sinking in the CAISO as a proxy for COTP total schedules*.

Contrary to SVP's claims, the CAISO does not "already have"¹³⁵ the data that SVP says it does and that it asserts can be used to avoid its modeling problems.

SVP also claims that the CAISO "fail[ed] in its attempt to develop an antithetical example to the one provided by [SMUD] witness Sorey, in which Mr. Sorey demonstrated that CAISO's default Captain Jack pricing would lead to reduced imports into CAISO's BAA."¹³⁶ SVP's statement is incorrect, the CAISO did provide a rebuttal to Mr. Sorey's example.¹³⁷

Finally, SVP claims that the opportunity to request CRRs to provide a financial hedge has severe limitations and would not adequately compensate for the exposure to congestion costs created by CAISO's Captain Jack pricing.¹³⁸ Part of SVP's assertion is based upon the nature of an obligation CRR.¹³⁹ However, there is no risk to holding an obligation CRR when a party's

¹³⁵ SVP Answer to Answer at 5 (item 2).

¹³⁶ *Id.* at 15.

¹³⁷ See July 23 Answer at n.72 and accompanying text. The example and discussion in the July 23 Answer at n.72 also responds to items 3 and 14 on page 4 of SVP's Answer to Answer. SVP states that the CAISO has not responded to its witnesses' testimony at 53-54 (item 14) and notes that "[i]t would be irresponsible for a system operator to purchase low cost energy using its available transmission, but then provide that energy for the benefit of the adjacent BAA, while using its highest cost energy for its own customers." SVP-2 at 54. However, as the CAISO's response makes clear, one can't know whether it would be "irresponsible" unless one knows the price spreads and if providing the energy to the adjacent BAA provides greatest benefit then the transaction would make sense from the perspective of the market participant.

¹³⁸ SVP Answer to Answer at 7 (item 18).

¹³⁹ See SVP-1 at 7.

day-ahead schedule matches the CRR source, sink and MW quantity. In other words, a CRR obligation can provide a perfect hedge even when 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 and the net congestion charge to the holder would still be zero.

Another aspect of SVP's reasoning is that a Load-Serving Entity ("LSE") is allocated a limited number of CRRs based on its peak load "less ETC rights" and that in obtaining CRRs (mapped back to Captain Jack) to offset the "improper allocation of *congestion charges between Captain Jack and Tracy*, SVP would have to forego getting CRRs from other sources."¹⁴⁰ These statements are illustrative of the error of SVP's arguments and the arguments of the other IBAA Entities. First, the IBAA proposal (and the use of virtual resources at external locations in the FNM) only pertains to service over the CAISO Controlled Grid. The CAISO will assess no congestion or losses for transmission service over the COTP between Captain Jack and the Intertie Scheduling Point at Tracy. The congestion and loss charges for service over the COTP, whatever they amount to, are charges under TANC's transmission tariff, not the CAISO (or MRTU) Tariff. SVP can receive a CRR from the Tracy Intertie Scheduling Point (mapped back to Captain Jack in the Full Network Model used for the CRR allocation process) to its load serviced off the CAISO Controlled Grid and that CRR will hedge its congestion costs associated with service over the CAISO Controlled Grid.

Second, if SVP has an ETC, the ETC has a perfect hedge for the congestion charges. For example, section 11.2.1.5 of the MRTU Tariff: reads as follows:

¹⁴⁰ *Id.* at 8 (emphasis added).

For all Points of Receipt and Points of Delivery pairs associated with a valid and balanced ETC Self-Schedule, TOR Self-Schedule or Converted Rights Self-Schedule, *the CAISO shall not impose any charge or make any payment to the Scheduling Coordinator related to the MCC associated with such Self-Schedules. For each Scheduling Coordinator, the CAISO shall determine the applicable IFM Congestion Credit, which can be positive or negative, as the sum of the products of the quantity scheduled in the Day-Ahead Schedule and the MCC at each eligible Point of Receipt and Point of Delivery associated with the valid and balanced portions of that Scheduling Coordinator’s ETC, TOR, and Converted Rights Self-Schedules.*¹⁴¹

Contrary to SVP’s allegations, the financial hedge available to LSEs via CRRs and through the treatment of valid ETC schedules do not have “severe limitations” or fail to compensate SVP for the congestion exposure for service over the CAISO Controlled Grid – which are the only facilities for which the CAISO manages congestion.

As noted earlier, there is no pre-existing entitlement to an LMP modeled on a radial basis at the Tracy Intertie Scheduling Point. The repeated efforts of SVP and others to claim that the difference between an LMP at Tracy (for an import modeled on a radial basis which assumes the resource is located at the Intertie Scheduling Point) and an LMP at Tracy (for an import modeled using a virtual resource at Captain Jack) *is the same thing as charging for congestion and losses for service over the COTP* is incorrect. The sole purpose of the IBAA proposal is to assess and accurately reflect the impacts of interchange transactions for service over the CAISO Controlled Grid.

Similarly, DOE asserts the CAISO is changing the settlement points for DOE transactions from Tracy to Captain Jack and the “difference between the Locational Marginal Prices at these two locations would greatly reduce the credit that DOE receives from the CAISO

¹⁴¹ MRTU Tariff Section 11.2.1.5 (emphasis added). *See also* MRTU Tariff Section 11.5.7 regarding the congestion hedge provided to balanced ETC schedules in the Hour-Ahead Scheduling Process and the Real Time Market.

for energy imported to meet DOE loads.”¹⁴² Again, these statements illustrate the position of the IBAA Entities that they are entitled to an LMP modeled on a radial basis at the Tracy Intertie Scheduling. This is incorrect and a central flaw undermining a significant portion of the protests filed in this proceeding.

In addition, the CAISO is not changing the settlement location for imports to the CAISO Controlled Grid at the Tracy Intertie Scheduling Point (*i.e.*, changing the settlement location from the Tracy Intertie Scheduling Point to the Captain Jack Substation as alleged by DOE). As the CAISO stated in the Transmittal Letter: “it is important to emphasize in responding to the arguments of the IBAA Entities . . . that the LMPs will be applied only to billing determinants associated with *service over CAISO Controlled Grid facilities*”.¹⁴³ The billing determinants for DOE’s import transactions at the Tracy Intertie Scheduling Point will be those determinants measured at the Tracy Intertie Scheduling Point.¹⁴⁴

I. Answer Filed by CCSF

In its Answer, CCSF states that:

[I]f the CAISO prices transactions at Tracy calculated as if they were scheduled at Captain Jack, CCSF will be denied the full benefit of the ETC right to obtain power at Tracy, *since the Captain Jack price will expose CCSF to additional loss charges that already will have been incurred by the counter party delivering the power to Tracy*. While the ETC Perfect Hedge would provide protection against congestion charges from Captain Jack to Tracy, it provides no protection against loss charges, which could significantly add to the cost of transactions under the ETC at Tracy.¹⁴⁵

¹⁴² DOE Answer to Answer at 4.

¹⁴³ Transmittal Letter to the June 17 Filing at 23, 47.

¹⁴⁴ The remaining arguments in DOE’s Answer to Answer are addressed in the July 23 Answer.

¹⁴⁵ CCSF Answer To Answer at 2-3 (emphasis added).

Similar to the issues discussed in the previous section, there is no duplicative cost or extra exposure to congestion charges or losses by virtue of modeling and calculating the LMPs at Tracy (applicable to imports from SMUD TID IBAA) using a virtual external resource in the Full Network Model at the Captain Jack Substation.¹⁴⁶

In its Answer, the CAISO stated that for the purposes of settling ETCs and TORs under MRTU as currently contemplated, the adoption of the IBAA proposal does not change the fact that the CAISO will provide the “perfect hedge” and priority of schedules consistent with the applicable PNodes established for the CAISO markets.¹⁴⁷ The CAISO also noted that this principle also applied to CCSF’s assertion that under its ETC with PG&E, because they are entitled to import at “Tracy,” they should also be entitled to a Tracy LMP (*i.e.*, modeled on a radial basis as if external resource used to implement the transaction were located at the interconnection point) and not be subject to either: (a) the default pricing point for imports (*i.e.*, an LMP at Tracy modeled as if the external resource used to implement the transaction were located at or near the Captain Jack Substation) or (b) a non-default modeling and pricing arrangement with an LMP at Tracy where the location of the external resource used to implement the transaction *is* located at or near the Captain Jack Substation.

CCSF then states the CAISO statement is “absurd” given that it presumes that the parties to the ETC contemplated a pricing point other than at a point of receipt or point of delivery identified in the ETC. CCSF explains its rationale stating that given:

¹⁴⁶ Regarding losses in particular *see* Transmittal Letter to the June 17 Filing at 14, 22-23 (including n. 66), and 49-50; and Exhibit ISO-1, Panel Testimony of Mark Rothleder and Dr. Price at 67-70.

¹⁴⁷ July 23 Answer at 81.

that MRTU was not in place at the time of CCSF's ETC, and that CAISO's IBAA pricing concept did not even exist until late 2007, it is impossible that CCSF's ETC would have a pricing point at Captain Jack, unless Captain Jack were identified as a point of receipt or point of delivery in the contract.¹⁴⁸

CCSF's argument is flawed. The CAISO was not disputing that CCSF is entitled to a "Tracy Price" and CCSF will receive a Tracy price under MRTU and the IBAA proposal. What the CAISO was stating (which is supported by CCSF noting that its ETC with PG&E predates the IBAA proposal) is that manner in which the price is developed for the pricing point (in this case the Tracy Intertie Scheduling Point) typically is not addressed by interconnection agreements and that this is the case with CCSF's Interconnection Agreement with PG&E. The CAISO does not dispute what points of delivery and points of receipt are permitted under the CCSF and PG&E ETC. Those points will continue to be available under MRTU. However, as is the case with all pricing points under MRTU, under the IBAA proposal the pricing points will reflect the locational cost of using the grid and the perfect hedge for CCSF's transactions will be applied accordingly. Nothing proposed by the CAISO in this proceeding changes the perfect hedge and priority of schedules for ETCs under MRTU, which has already been accepted by the Commission. The request that the CAISO extend the ETC rights beyond the perfect hedge and the priority of schedules for the treatment of ETCs under MRTU so that CCSF is guaranteed a price for energy at Tracy it deems to be favorable, is entirely beyond the scope of this proceeding.

¹⁴⁸ CCSF Answer to Answer at 3-4.

J. There Are No Material Issues of Fact Or A Need for Trial-Type Hearing Procedures

TANC asserts that contrary to CAISO's Answer,¹⁴⁹ trial type hearing procedures are warranted because of material issues of fact.¹⁵⁰ TANC cites three areas that support its request for hearing procedures: (i) the fact that the Captain Jack Substation is not an accurate pricing point because it is not a resource point;¹⁵¹ (ii) TANC and others have demonstrated that the CAISO's criteria for establishing IBAs is unduly discriminatory;¹⁵² and (iii) that the IBAA proposal "devalues" the COTP.¹⁵³ The CAISO has responded to these issues and they do not present any material issue of fact.

As noted in the July 23 Answer, these issue are primarily policy questions. For example, there is no need for a hearing to explore the fact that the Captain Jack Substation is not a resource point. The issue of whether the CAISO models on a radial basis as TANC and others request using a fictional resource located at or near the Tracy Intertie Scheduling Point or models the impact of interchange transactions by placing a virtual resource at an external locations in the Full Network Model does not turn on whether the modeling location is a literal generating resource or another element of the network like a substation. Rather, the issue depends on

¹⁴⁹ See July 23 Answer at 19-21 (regarding the lack of a need for hearing procedures).

¹⁵⁰ TANC Answer to Answer at 13-14.

¹⁵¹ *Id.* at 13. TANC also claims that because of the CAISO's claim that "location matters for purposes of setting prices in an LMP market" all aspects of the default single-hub pricing proposal raise issues of material facts. *Id.*

¹⁵² *Id.*

¹⁵³ *Id.* at 14.

whether the modeling location adequately represents the impact of interchange schedules on internal transmission constraints on the CAISO Controlled Grid.¹⁵⁴

Regarding the issues of whether the IBAA proposal is unduly discriminatory or whether it devalues the COTP, the CAISO strongly disagrees with these claims. However, regardless of the CAISO's opinion, the point in this instance is that there is more than a sufficient record on which the Commission can decide the issues -- there is no need for hearing procedures on either the default aspects of the IBAA proposal or the option to obtain non-default modeling and pricing. If the Commission desires more information on any aspect of the IBAA proposal, the CAISO respectfully asks that the Commission establish a supplemental briefing schedule to satisfy the Commission's needs and not set the IBAA proposal for hearing before an Administrative Law Judge.¹⁵⁵

In addition, the CAISO is in discussions with TANC and the other IBAA Entities regarding the establishment of a MEEA. The CAISO will continue with those negotiations and has already requested the use of the Commission's Dispute Resolution Service ("DRS") to assist in the negotiations. As noted earlier, the negotiations do not diminish or eliminate the need for the Commission's approval of the IBAA with the default pricing points prior to start of MRTU.¹⁵⁶ However, the CAISO does not object to the use of Settlement Judge procedures to

¹⁵⁴ See Exhibit ISO-3, Testimony of Dr. Harvey, at 27-28.

¹⁵⁵ See, e.g., *FPL Energy Marcus Hook, L.P., Complainant v. PJM Interconnection, L.L.C Respondent*, 114 FERC ¶ 61,296 at PP 2, 7-9 (2006) (establishing a briefing schedule with respect to the interpretation of Section 37.2 of the PJM OATT); *California Independent System Operator Corp.*, 114 FERC ¶ 61,022 at P 20 (2006) (establishing a briefing schedule with respect to petitions for review of an arbitration award); and *Midwest Independent Transmission System Operator, Inc., PJM Interconnection, L.L.C.*, 108 FERC ¶ 61,248 at P 1 (2004) (Order Establishing Briefing Schedule and Dismissing Complaint).

¹⁵⁶ July 23 Answer at 116-118.

assist in establishment of a specific MEEA agreement with any (or all) of the IBAA Entities (or any other market participant) so long as it is clear that the scope of the procedures is to develop an entity-specific MEEA and not to revisit the design or approval of the IBAA proposal.

Moreover, the establishment of a MEEA need not occur prior to MRTU start up because the default IBAA proposal provides a just and reasonable solution to the issues identified. Nor is it justifiable that the Commission allow the parties to succeed in derailing the CAISO's implementation of MRTU when CAISO's resources are already constrained. Clearly the record as reflected in the series of MRTU orders issued by the Commission shows that the benefits MRTU will provide the California market are significant. Having already provided a method for giving the parties the more favorable non-default pricing they desire (provided the arrangement provides the information that allows the CAISO to verify the location and dispatch of the external resources as discussed by Dr. Harvey and Dr. Hildebrandt), the CAISO sees no reason why the benefits of MRTU should be delayed any further than necessary for a successful launch of MRTU.

K. The Entities Supporting the IBAA Proposal

In the introduction to the July 23 Answer, the CAISO listed: (i) the entities that filed motions to intervene with no substantive comments, (ii) the entities that filed comments and/or protests, and (iii) the entities that supported the IBAA proposal (citing Pacific Gas and Electric Company ("PG&E"), San Diego Gas & Electric Company ("SDG&E"), Southern California Edison Company ("SCE"), California Public Utilities Commission ("CPUC"), and Powerex

Corp. (“Powerex”) as supporters). SMUD claims the CAISO’s statements that SCE, Powerex, and the CPUC support the filing are in error.¹⁵⁷

SCE states that: “[i]n general, SCE supports the CAISO’s filing and believes the proposed changes are reasonable approaches that will improve reliability of the CAISO controlled electric grid and improve the CAISO’s ability to manage congestion between the Day-Ahead and Real-Time markets.”¹⁵⁸ Similarly, Powerex states that it: “generally supports the CAISO’s goal of ensuring more accurate pricing and modeling of interchange transactions on the CAISO Controlled Grid” but notes that the CAISO “should provide additional information regarding how it will model transmission congestion and losses at the Captain Jack Substation.”¹⁵⁹ The CPUC states that it: “generally supports many of the objectives the CAISO’s IBAA filing.”¹⁶⁰ The CAISO noted that these entities filed comments as well as noting the “support” the entities expressed for the IBAA proposal.¹⁶¹ The purported inconsistencies claimed by SMUD are incorrect.

In contrast, SMUD is correct that the CAISO stated that the Salt River Project (“SRP”) and Nevada Power Co. and Sierra Pacific Power (“NPC-SPPC”) were entities that only filed

¹⁵⁷ SMUD Answer to Answer at 6-7.

¹⁵⁸ SCE Comments at 2.

¹⁵⁹ Powerex Comments at 1. Powerex also urged the Commission to: (i) “clarify that the CAISO must file in advance of implementing a new IBAA or significantly modifying an existing IBAA” which the CAISO has committed to do, and “provide guidance to assist the parties in resolving the significant seams issues presented in this proceeding.” *Id.*

¹⁶⁰ CPUC Comments at 3 (the CPUC does not object to the IBAA proposal but notes the resistance of others and offers its assistance in negotiating “an agreeable outcome”). *Id.*

¹⁶¹ *See* July 23 Answer at 2, n.5.

motions to intervene.¹⁶² The CAISO mistakenly overlooked the participation of SRP and NPC-SPPC in the protest of WestConnect.¹⁶³

IV. CONCLUSION.

Wherefore, the CAISO respectfully requests that the Commission accept the CAISO's Answer and approve the CAISO's IBAA proposal as discussed herein, without suspension or hearing.

Respectfully submitted,

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¹⁶² See SMUD Answer to Answer at 7 and the July 23, Answer at 2, n.4.

¹⁶³ See WestConnect Protest at 1, n.1.

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 Washington, D.C. on this 8th day of August, 2008.

/s/ Andrew M. Jamieson
