UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket No. ER08-73-000**

REQUEST FOR CLARIFICATION, OR IN THE ALTERNATIVE, REHEARING OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 825*l*(a) (2001), and Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713 (2006), the California Independent System Operator Corporation ("CAISO")[1] hereby submits this Request for Clarification, or in the Alternative, Rehearing of the Commission's order issued on June 20, 2008, 123 FERC ¶ 61,288 (2008) ("June 20 Order") in the above captioned docket. Specifically, the CAISO requests that the Commission clarify that because there is no publicly available index for gas futures contracts for delivery points in California for six months into the future, and that alternative methodologies for approximating such an index would be unreliable and lack transparency, the CAISO should calculate caps for Start-Up and Minimum Load Costs using gas futures prices at Henry Hub, as the CAISO proposed in its original filing. If the Commission declines to provide such clarification, the CAISO respectfully requests rehearing.

[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the MRTU Tariff.

I. STATEMENT OF ISSUES

The CAISO respectfully requests that the Commission clarify, or in the alternative, grant rehearing of the following with respect to the June 20 Order:

- The Commission should clarify that, in the absence of a transparent publicly available index for gas futures contracts for delivery points in California, the CAISO will calculate caps for Start-Up and Minimum Load Costs using proxy gas prices based on the highest price for monthly gas contracts at Henry Hub over a forward-looking six month period as proposed by the CAISO.

- If the Commission declines to grant this clarification, then the CAISO requests rehearing of the Commission's decision to require the CAISO to use a California-specific index for calculating Start-Up and Minimum Load caps.

II. BACKGROUND

On October 19, 2007, the CAISO filed an amendment to its MRTU Tariff ("SU-ML Cap Amendment") to provide limits to Start-Up and Minimum Load Costs for suppliers that are eligible to recover such Costs in accordance with the Registered Cost Option, as set forth in Section 30.4 of the MRTU Tariff. As the CAISO explained in the transmittal letter accompanying the filing, it proposed adding these limits in order to protect against the potential exercise of market power by suppliers through the submission of extremely high Start-Up and Minimum Load Costs, particularly in resource-constrained areas of the CAISO grid.

The SU-ML Cap Amendment proposes different caps based on whether a unit is located in a Local Capacity Area ("LCA"). For those units within LCAs, Start-Up and Minimum Load Costs under the Registered Cost Option may not exceed 200 percent of the unit's projected Start-Up and Minimum Load Costs. For units outside of LCAs, Start-Up and Minimum Load Costs under the Registered Cost Option may not exceed 400 percent of the unit's projected Start-Up and Minimum Load Costs. One of the main components in determining projected costs is the price of gas. In the SU-ML Cap Amendment, the CAISO explained that it would determine gas prices used in calculating caps based on the highest price for monthly gas contracts at Henry Hub over a forward-looking six month period. Prior to filing its proposal for calculating projected costs, the CAISO performed extensive analysis of the historical volatility of daily spot market gas prices in California relative to the forward price of monthly gas contracts at Henry Hub in order to assess the potential risk that extreme spikes in the daily spot market gas prices could make the actual Start-Up and Minimum Load costs of units (given spot market gas prices) higher than the proposed cap, and determined that the proposed caps provided an appropriate level of "headroom" to cover the maximum spike in gas prices that have occurred over the last five years (relative to the NYMEX futures prices in the preceding six months) with a very high level of confidence.

In the June 20 Order, the Commission accepted the CAISO's proposal to develop the projected proxy cost using the highest average monthly price for gas contracts over a forward-looking six month period. However, the Commission stated that futures contracts with a delivery point at Henry Hub, Louisiana, are not sufficiently representative of natural gas prices for California or Western natural gas delivery points, and therefore, the CAISO should adopt a more localized, California reference point in developing proxy natural gas prices for purposes of calculating Start-Up and Minimum Load caps.

III. REQUEST FOR CLARIFICATION, OR IN THE ALTERNATIVE, REHEARING

As noted above, the Commission agreed with the CAISO that it should develop the proxy cost for gas used in calculating Start-Up and Minimum Load caps based on gas futures contracts over a six month period. In light of this ruling, the CAISO understands that the Commission's directive to use a "more localized, California reference point," means that the CAISO should calculate Start-Up and Minimum Load caps using a transparent gas futures index for California delivery points, which, of course, assumes that a gas futures index similar to the one for Henry Hub is available for California delivery points. To the best of the CAISO's knowledge, however, there is no index of natural gas futures contracts published for delivery points in California for a forward-looking six month period. Accordingly, it is not possible for the CAISO to comply with the strict letter of the Commission's ruling, and, therefore, the CAISO is requesting clarification, as described below, regarding the appropriate manner in which to resolve this issue.

The CAISO has explored whether there might be other alternatives for complying with the Commission's directive to use a California reference point, while still basing the cost of gas on Henry Hub futures prices. One possibility that the CAISO has considered is modifying its Start-Up and Minimum Load cap methodology to incorporate daily prices for "basis swaps," which, the CAISO understands, represent the differential between prices for monthly contracts at Henry Hub compared to final settlement prices for month ahead gas contracts at various delivery points in California. To the best of the CAISO's knowledge, data on a variety of different such basis swaps are available through two markets, NYMEX and IntercontinentalExchange ("ICE"). If available for use by the CAISO, prices for these basis swaps could be combined with Henry Hub futures prices to determine possible representative future gas prices for delivery points in California on a forward-looking six month basis. However, based on a preliminary analysis of this option, the CAISO believes that there are significant downsides to this approach, in addition to the time and expense that would be involved if the CAISO were required to calculate projected future gas prices using this approach. Moreover, there is already a strong correlation between spot market gas prices at Henry Hub and California delivery points, such that including basis swap data in the Start-Up and Minimum Load cap calculations would provide little to no additional benefit to Market Participants.

The CAISO's most significant concern with respect to incorporating basis swaps into its gas price methodology is the robustness and liquidity of those markets. One of the reasons that the CAISO originally proposed using NYMEX futures contracts for Henry Hub is because it is the most liquid and transparent index for gas prices on a forward-looking six month basis that would be easily accessible to all Market Participants. However, the CAISO is uncertain as to whether the markets in which the various different basis swap products are offered are sufficiently robust and liquid to yield prices reliable enough to be used in setting bid caps in the CAISO markets. The CAISO is also concerned with the transparency of the basis swap data. Although prices for NYMEX monthly gas futures on a forward-looking six month basis are publicly posted each day on the internet, the CAISO's understanding is that daily prices for basis swaps on a forward-looking six month basis are only available to participants in these other markets or via proprietary data services. The CAISO believes that this lack of transparency is at odds with the Commission's intended outcome in the June 20 Order.

Meanwhile, after analyzing spot market gas prices at both Henry Hub and California delivery points, the CAISO has determined that prices at Henry Hub are in fact an extremely accurate indicator of the upper range of prices that could be expected at delivery points in California on a six month forward-looking basis. As noted in the June 20 Order, the CAISO's proposed approach was buttressed by an analysis of actual historical gas data over the last five years, and based on this evidence, the Commission determined that the CAISO's proposed caps were reasonable.[2] This analysis included a comparison of NYMEX futures prices for Henry Hub to daily spot market gas prices for various delivery points within California, thus demonstrating that the CAISO's proposed approach can be expected to yield projections of gas costs slightly higher than the actual maximum spot market price for gas at delivery points within California. These results indicated that the approach proposed by the CAISO provided some additional "headroom" in the event of spikes in daily spot market prices at delivery points in California – a fact specifically noted by the CAISO's Market Surveillance Committee as factoring into their decision that the proposed approach provided an appropriate level of "headroom" to account for potential spikes in daily spot market gas prices at delivery points within California.[3]

---

[2] June 20 Order at P 25.

[3] In commenting on the analysis of gas prices performed by the CAISO, the MSC specifically stated that "a lower cap would increase the probability of non-cost recovery under [the Registered Cost Option] and resulting generator requests to revise bids, which we believe is undesirable." MSC Opinion at p 2-3, http://www.caiso.com/1c3b/1c3b939e38cb0.pdf.

This point is further illustrated in Figure 1 in Attachment A to this filing, which shows a comparison of the monthly average of gas prices in the daily spot market at various delivery points in California to comparable average prices for spot market gas at Henry Hub. The close relationship between gas prices at Henry Hub and delivery points in California is also reflected in the very high statistical correlation of daily prices at these different delivery points, which has consistently ranged just above or below 90 percent for each year since 2002, as illustrated in Table 1 in Attachment A.

Also, while the CAISO's proposal was designed to result in caps with significant "headroom" in the event of spikes in daily spot market prices at delivery points in California, the CAISO's overall approach was modified to allow generators to switch to the Proxy Cost option in the event that gas prices rose so high that Start-Up and Minimum Load Cost bids submitted under the six month Registered Cost option did not cover a generator's actual costs. Under the Proxy Cost option, a generator's Start-Up and Minimum Load Cost bids would be automatically updated based on daily spot market gas costs at delivery points within California. Thus, the option of switching to the Proxy Cost option provides further assurance that use of Henry Hub futures prices to set Start-Up and Minimum Load caps under the Registered Cost option will not result in an inability of generators to recover their actual costs.

For these reasons, the CAISO requests that the Commission clarify that (1) its directive to calculate Minimum Load caps using a "more localized, California reference point" was premised on the existence of a transparent gas futures index for California delivery points, and (2) given that such an index does not exist, the downsides associated with attempting to approximate such an index using basis swap data discussed above, and the strong correlation between Henry Hub and California spot market gas prices, the most appropriate solution is for the CAISO to calculate Start-Up and Minimum Load caps using gas costs derived from the highest price for monthly gas contracts at Henry Hub over a forward-looking six month period, as originally proposed in the SU-ML Cap Amendment. The only impact that the small average difference between Henry Hub and California gas prices will likely have is that under the CAISO's proposed approach the "headroom" that generators will have to guard against gas price spikes is slightly increased relative to an approach that also factors in prices for basis swaps or some other method of trying to account for differences in prices at Henry Hub and various delivery points within California. This slight potential difference between the two approaches demonstrates that the CAISO's original proposal is well within the zone of justness and reasonableness. This is also reflected in the fact that no party objected to the CAISO's use of Henry Hub gas prices in its calculation. If the Commission declines to grant the requested clarifications, then the CAISO respectfully requests that the Commission grant rehearing on this issue for the same reasons as set forth above.

Finally, as noted above, the CAISO's analysis regarding the possibility of incorporating basis swap data into its Start-Up and Minimum Load cap calculations is preliminary, and if the Commission were to require the CAISO to do so, despite the CAISO's arguments to the contrary, the CAISO requests Commission guidance and additional time to resolve implementation details, such as the exact data to use, and negotiating use of the data with the publisher, including the extent to which that data can be made as transparent as possible. The CAISO also believes that such a process should involve stakeholder input, review and discussion. Therefore, if the Commission does require the CAISO to use basis swaps in calculating Start-Up and Minimum Load caps, the CAISO requests that the Commission allow the CAISO sixty days to make a compliance filing implementing this methodology.

IV. CONCLUSION

Wherefore, for the reasons discussed above, the CAISO respectfully requests that the Commission clarify that the CAISO will calculate Start-Up and Minimum Load caps using gas costs derived from the highest price for monthly gas contracts at Henry Hub over a forward-looking six month period, as proposed in the SU-ML Cap Amendment. If the Commission declines to provide such clarification, then the CAISO respectfully requests that the Commission grant rehearing on this issue and revise the June 20 Order accordingly.

Respectfully submitted,

*/s/ Michael Kunselman*_____

Nancy Saracino
General Counsel
Sidney M. Davies
Assistant General Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Fax: (916) 608-7246
Tel: (916) 351-4400
E-mail: sdavies@caiso.com

Michael Kunselman
ALSTON & BIRD LLP
The Atlantic Building
950 F Street, NW
Washington, DC 20004
Tel: (202) 756-3300
Fax: (202) 756-3333
E-mail:michael.kunselman@alston.com

Dated: July 21, 2008

Certificate of Service

I hereby certify that I have this day served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated this 21st day of July, 2008 at Washington, D.C.

_____ */s/ Michael Kunselman*_____
Michael Kunselman
(202) 756-3395

ATTACHMENT A

Figure 1. Differential Between Average Monthly Spot Price at Major California Delivery Points versus Henry Hub

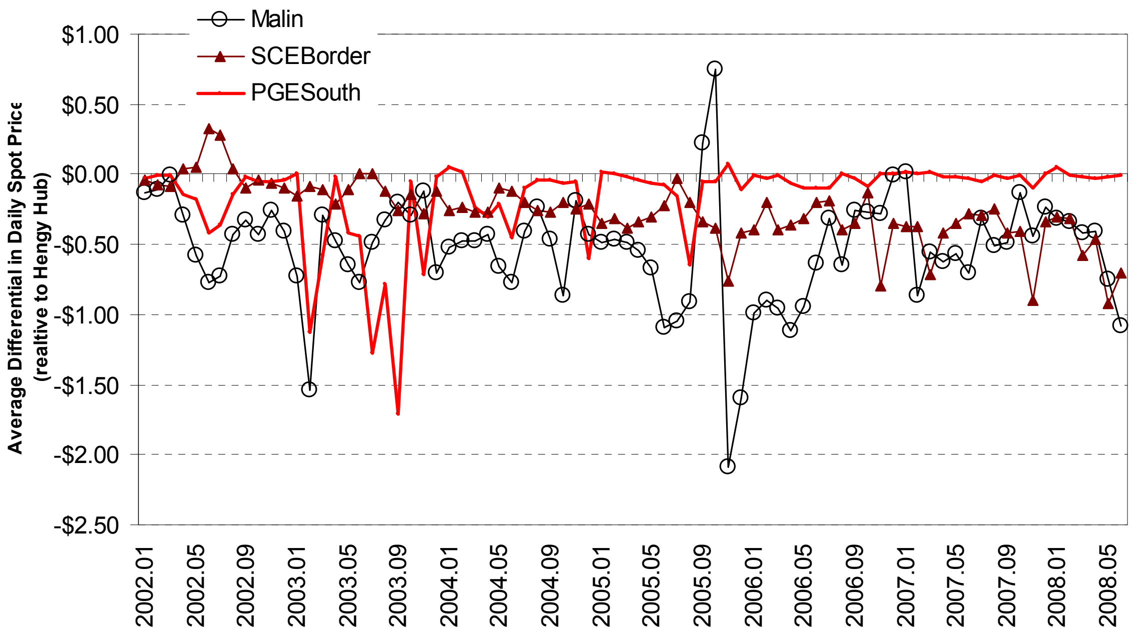

Table 1. Correlation of Daily Spot Market Prices at Henry Hub With Prices at California Delivery Points

	Delivery Point			
Year	Malin	PGE City Gate	PGE South	SCE Border
2002	.91	.92	.91	.95
2003	.90	.87	.94	.89
2004	.89	.88	.88	.88
2005	.98	.98	.97	.97
2006	.93	.93	.92	.92
2007	.88	.88	.78	.79
2008	.99	.99	.94	.93