UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Credit Reforms in Organized Wholesale Electric Markets	**)** **)** **)**	**Docket No. RM10-13-000**

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

The California Independent System Operator Corporation (California ISO) submits these further supplemental comments on the Notice of Proposed Rulemaking issued by the Federal Energy Regulatory Commission on January 21, 2010, to address the Commission's proposal that ISOs and RTOs "clarify their status as a party to" transactions in their markets.

The California ISO previously submitted comments on March 15 (jointly with the Midwest ISO) and March 29, as well as supplemental comments on June 8, following the technical conference. These further supplemental comments address additional issues which came to the ISO's attention subsequent to those comments.

I. Mandating counterparty status could inadvertently subject ISOs and RTOs to regulation under greenhouse gas regulatory schemes.

Recognizing that requiring ISOs and RTOs to become parties to market transactions could "have ramifications beyond addressing the risk highlighted here," the Commission asked for comments about the collateral implications of adopting such a requirement. *See* Notice of Proposed Rulemaking issued January 21, 2010, ¶ 25.

Although the Commission received a number of comments discussing potential consequences of the proposed rule, an additional consequence not previously discussed is the potential implication for an ISO or RTO to become a "point of regulation" under greenhouse gas ("GHG") regulatory schemes. Point of regulation refers to the entity responsible for retiring GHG allowances.

In California, the Air Resources Board ("ARB") is preparing regulations during 2010 to implement state law regulating greenhouse gas emissions, commonly known as A.B. 32, which put emission reduction requirements in place by 2012.[1] Because those subject to the regulations are the parties to electricity transactions, denominating the California ISO as a party to the transactions could subject it to state greenhouse gas regulation. Importantly, the mandated greenhouse gas reductions under A.B. 32 extend not only to electricity produced in California, but also *to electricity consumed* in California, meaning electricity imported for use in the state. The ARB's draft regulations for the electricity sector make an "electricity deliverer" the point of regulation. The regulations define an "electricity deliverer" as the owner of the electricity as it enters California, *i.e.* as the electricity is delivered to the California grid, the point of regulation for electricity imported for consumption in California. This party bears the obligations to report GHG emissions from imported electricity and to procure the emissions allowances and offsets that are the mechanism to keep California GHG emissions within the proscribed limits.[2] The draft regulations define an "electricity deliverer" as

[1] California Global Warming Solutions Act (AB 32; Nunez Sept 2006), codified in California Health & Safety Code Sections 38500 et seq. For further information about AB 32, *see* the California Air Resources Board's Climate Change website (http://www.arb.ca.gov/cc/cc.htm).

[2] *See* California Air Resources Board, Preliminary Draft Regulation for a California Cap-and-Trade Program (Nov. 24, 2009) (http://www.arb.ca.gov/cc/capandtrade/meetings/121409/pdr.pdf).

"either an electricity generating facility (covering in-state generators) or an electricity importer that delivers power to a point on the California electricity transmission and distribution system." *Id*. § 95802(a)(48). An "electricity importer" is in turn defined as "an owner of electricity generated outside of California as it is delivered to the first point in California." *Id.* § 95802(a)(50).

As the first data on GHG emissions came due this year (AB 32's timelines put the reporting regulations in place before the emissions allowance requirements), the ARB apparently had been assuming that, for transactions importing electricity into California, the "electricity deliverer" would be the ISO market participant that scheduled the import into the ISO. The ARB has become concerned, however, that it may be challenging to regulate import transactions where the scheduled point of delivery to the California grid within an ISO balancing area delivery point that is just outside the California border. This is a common occurrence, as several of the major import hubs on the California ISO grid are located outside of California, including "COB" (the California-Oregon Border), "NOB" (the Nevada-Oregon Border), "Four Corners," "Mead," and "Palo Verde."

Consequently, ARB staff recently told the ISO that the ARB may try to look to the ISO as the "electricity importer" responsible for reporting emissions and procuring and submitting to ARB emissions allowances for the emissions associated with these California imports. The California ISO has advised state regulatory agencies that because the ISO itself does not take title to or ownership of the power, and only facilitates transactions on behalf of market participants, that it believes that the ISO is never the deliverer under the proposed point of regulation, though this remains possible until the regulations are finalized.

The fact that the ISO does not have an "ownership interest" and is not a party to the sale/purchase transaction is a key one to the assessment of whether the California ISO should be a point of regulation under the regulatory construct. The California ISO's current FERC-approved tariff specifies that the ISO is an agent for the market participants that procure energy – not a principal – and so the California ISO should not be considered an "electricity deliverer" under the California law. *See* ISO Tariff § 22.13 ("the CAISO will not act as principal but as agent for and on behalf of the relevant Scheduling Coordinators"). This could change, however, if the Commission were to adopt a rule requiring the California ISO to become a counterparty to market transactions.

ISOs and RTOs would not be an effective point of regulation for GHG emissions because they cannot respond to the intended incentives, as would be done by the ultimate purchaser or seller of electric power. The California ISO, in particular, is not the end-use consumer, and cannot decide to use alternative, non-carbon intensive fuels in the power-pool, when regulatory situations (such as the cost or availability of GHG allowances or the offsets in the allowance market) make it appropriate to forgo carbon intensive resources. As noted by the California ISO's Market Surveillance Committee:

> It will not be possible for the ISO to define, for example, different locational marginal prices (LMPs) for dirty and clean power at each bus, or to explicitly consider relative emissions rates in deciding what units will be chosen to provide, say, spinning reserves or residual unit commitment services. [The redesigned ISO markets] will not be able to accommodate demand bids that express a higher willingness to pay for low emissions power. Power and ancillary services from various sources with various emissions rates will be inextricably mingled within the ISO markets.

See California ISO Market Surveillance Committee, Opinion on "Load-Based and Source-Based Trading of Carbon Dioxide in California" (November 27, 2007), *at page 7.*[3] Thus, a requirement to procure emissions credits would add costs and impede the California ISO's ability to deliver low cost service to its customers without the corresponding benefit. Moreover, if greenhouse gas regulation is adopted on a national level, counterparty status could make ISOs and RTOs inviting targets for regulation, impeding the efficient use of markets and adding cost to ISO and RTO customers.

Adopting the proposed rule requiring counterparty status could also skew market transactions by creating an incentive for electricity exporters into California (and conceivably purchaser and importers within California), who really intend the power to be for California consumption, to have the power dumped just before the California border, in order to impose upon the ISO the administrative burden and expense of compliance with ARB reporting and allowance requirements, and to relieve themselves of this requirement.

The fact that the ISO is an agent, rather than a principal with respect to transactions in its markets has been foundational to the ISO's business arrangements, and, in particular, its ability to raise capital notwithstanding the defaults associated with the California energy crisis of 2000-2001. *See* Comments of the California Independent System Operator on Notice of Proposed Rulemaking, filed March 29, 2010, at p. 16. The full ramifications and collateral implications of the proposed rule remain unknown, and potential regulation, on the state and national level, of greenhouse gas emissions is just one example.

[3] Available at http://www.caiso.com/1c9d/1c9d6f661ba60.pdf.

II. The suggestion that ISOs and RTOs should become counterparties to achieve national clearing is premature and has not been fully explored.

The Committee of Chief Risk Officers has suggested that ISOs and RTOs should become counterparties to market transactions as a means to achieve national clearing. *See* Comments of the Committee of Chief Risk Officers, submitted March 29, 2010. Their proposal was discussed at a June 22 meeting of the Commodities Future Trading Commission, where panelists testified about the benefits of national netting and clearing. The premise of this discussion was that national clearing could be achieved only if the ISOs and RTOs themselves take title to the transactions in their markets, which they would in turn transfer to a clearinghouse. In other words, the discussion assumes that the benefits of national clearing support the NOPR proposal to require counterparty status.

There is reason to doubt this premise. As the California ISO has previously explained, it is not opposed to national clearing. Rather, the California ISO opposes becoming a counterparty itself. (Transcript of May 11 Technical Conference at 30). Moreover, there are other means to be explored for achieving national clearing without creating counterparty status for ISOs and RTOs, such as the potential for creating a clearinghouse to become a party to the transactions. The point is, it is premature to conclude that counterparty status is a necessary step for national clearing, and ISOs and RTOs should be provided the opportunity to weigh-in as this issue continues to be explored.

III. Conclusion

The California ISO believes that the aspect of the NOPR regarding counterparty status for ISOs and RTOs has not been thoroughly vetted. Not only were there incorrect facts presented in the NOPR, but there is no reason to believe that the discussion has identified all implications of the proposed rule, or provided the record necessary for the Commission to conclude that the benefits of the rule would outweigh the costs. Requiring counterparty status would reverse a foundational assumption of the California ISO's business operations. Before the Commission requires such a significant step, it should ensure that all relevant considerations and alternatives have been carefully considered.

July 23, 2010

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon the parties listed on the official service list in the 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 at Folsom, California this 23rd day of July, 2010.

/s/ Jane Ostapovich

Jane Ostapovich