

UNITED STATES OF AMERICA 131 FERC ¶ 63,013
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System
Operator Corporation

Docket No. ER10-188-000

CERTIFICATION OF UNCONTESTED SETTLEMENT

(Issued May 5, 2010)

TO THE COMMISSION:

1. On March 23, 2010, the California Independent System Operator Corporation (CAISO), on behalf of itself and the Settling Parties,¹ filed an Offer of Settlement (Settlement Agreement) in the above-captioned proceeding. On April 12, 2010, CAISO, Commission Trial Staff (Staff), and the Alliance for Retail Energy Markets (Alliance) filed initial comments in support of the Settlement Agreement. The California Department of Water Resources State Water Project (SWP) also filed initial comments on April 12, 2010.² SWP does not oppose the Settlement Agreement. Rather, SWP clarified its position that the Settlement Agreement would have more accurately reflected the principle of cost causation if it exempted Existing Transmission Contracts (ETCs) from the Market Usage-Forward Energy (MUFE) component of the Grid Management Charge (GMC). On April 22, 2010, CAISO and Staff filed reply comments in support of the Settlement Agreement. The Settlement Agreement resolves all issues set for hearing in *California Independent System Operator Corporation*, 129 FERC ¶ 61,292 (2009) (Hearing Order). As the period for comment concluded without challenge, the Settlement Agreement stands uncontested.

¹ The Settling Parties include Calpine Corporation, Citigroup Energy, Inc., Dynegy Morro Bay, LLC, Dynegy Moss Landing, LLC, Dynegy Oakland, LLC, and Dynegy South Bay, LLC, Morgan Stanley Capital Group, Inc., Pacific Gas and Electric Company, Powerex Corp., San Diego Gas & Electric Company, and Southern California Edison Company.

² Due to unforeseeable circumstances, SWP filed initial comments on April 12, 2010 after the 5:00 p.m. Eastern Time filing deadline. Therefore, on April 13, 2010, SWP filed a motion requesting the Commission to allow and accept its initial comments on the Settlement Agreement one day out-of-time.

CASE SUMMARY

2. On February 20, 2008, CAISO filed a tariff amendment revising its GMC rate design to accommodate CAISO's market operations under its Market Redesign and Technology Update (MRTU). The Federal Energy Regulatory Commission (Commission) accepted CAISO's proposed amendment, with the exception of two modifications protested by the parties.³ The Commission directed CAISO to submit a compliance filing including previously accepted language regarding load-following metered sub-systems that CAISO had proposed to delete from its tariff.⁴ The Commission also directed CAISO to propose tariff language addressing the treatment of inter-scheduling coordinator trades in calculating MUFEE charges.⁵ The MUFEE charge recovers the portion of CAISO's costs incurred by administering markets that are associated with forward energy purchases and sales.

3. On January 21, 2009, CAISO submitted its compliance filing. CAISO proposed to clarify that the MUFEE charge would apply to energy in the day-ahead market as offset by physical, but not financial, inter-scheduling coordinator trades. In response to a protest filed by the Northern California Power Agency, CAISO filed an answer in which it agreed that both types of trades should be included in the MUFEE charge allocation formula. CAISO offered to file tariff revisions with this clarification. Lastly, CAISO stated that it would conduct a future stakeholder process to re-evaluate the MUFEE charge, including recovery of the administrative costs associated with inter-scheduling coordinator trades.⁶

4. The Commission accepted CAISO's GMC compliance filing, subject to a further compliance filing by CAISO consistent with the positions in CAISO's answer.⁷ The Commission accepted CAISO's subsequent compliance filing on July 14, 2009.⁸

³ *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,338 (2008).

⁴ *Id.* at P 40.

⁵ *Id.* at P 46.

⁶ *Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,021 at P 4, *reh'g denied*, 129 FERC ¶ 61,293 (2009) (citing CAISO Answer, Docket No. ER08-585-001, filed February 26, 2009 at 3).

⁷ *Cal. Indep. Sys. Operator Corp.*, 126 FERC ¶ 61,289 at P 7 (2009).

⁸ *Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,021.

5. Consistent with its commitment, CAISO initiated a stakeholder process concerning the MUFEE charge on August 3, 2009, and held a stakeholder meeting on August 18, 2009. CAISO posted a straw proposal on August 28, 2009, and held a second stakeholder meeting on September 15, 2009. After a subsequent stakeholder conference call on September 30, 2009, CAISO posted its final proposal on October 2, 2009. CAISO conducted a final stakeholder conference call on October 21, 2009.

6. On October 30, 2009, CAISO filed proposed tariff revisions to extend the existing GMC until December 31, 2010, with one exception: CAISO proposed to revise the MUFEE charge (i) to exclude inter-scheduling coordinator trades from the calculation, (ii) to base the charge on day-ahead energy schedules rather than purchases and sales, and (iii) to calculate the charge based on the greater of a Scheduling Coordinator's total supply schedules or total demand schedules, rather than the difference between purchases and sales (the "modified gross" approach).

7. In support of its filing, CAISO noted that, although allocating the MUFEE charge to "gross" energy schedules, rather than to "net" energy schedules, is the most consistent approach with the principle of cost causation, replacing the current netting approach with a gross approach could have excessive rate impacts on some Scheduling Coordinators. To mitigate such impacts, CAISO proposed the modified gross approach as an interim measure until CAISO's completion of a new cost-of-service study for the GMC.

8. No parties protested CAISO's proposed amendment. Some, however, stated concerns about the proposed allocation of the MUFEE charge and expressed a preference for a different allocation, and others challenged CAISO's statements regarding cost causation. On December 30, 2009, the Commission accepted CAISO's amendment with one exception. The Commission found that CAISO had failed to justify the modified gross approach as just and reasonable. The Commission suspended the MUFEE charge for five months and set it for hearing.⁹

9. On January 20, 2010, the undersigned convened a settlement conference. During the settlement process, CAISO presented additional information regarding the cost impact of various potential allocations of the MUFEE charge and answered questions. Several parties expressed their positions concerning CAISO's proposal. The settlement conference adjourned until March 3, 2010 to allow the parties to exchange information and to continue informal discussions.

10. On February 23, 2010, CAISO circulated a settlement proposal and revised it on February 25, 2010. On March 3, 2010, the parties met telephonically for further discussions. Based upon the discussions, CAISO made additional changes to the

⁹ *Cal. Indep. Sys. Operator Corp.*, 129 FERC ¶ 61,292 at P 22 (2009).

proposal. CAISO circulated a revised proposal on March 5, 2010. Subsequently, the Settling Parties joined CAISO in formulating the Settlement Agreement.

THE OFFER OF SETTLEMENT

11. The Settlement Agreement consists of the following documents: (i) the Transmittal Letter; (ii) the Settlement Agreement, which includes tariff sheets implementing the Settlement Agreement (Attachment A) and black-lined versions of the tariff sheets (Attachment B); (iii) the Explanatory Statement in support of the Settlement Agreement; and (iv) a Draft Letter Order approving the Settlement Agreement. The terms of the Settlement Agreement are as follows:

12. Section 1.1 states that all defined terms shall have the meaning set forth in CAISO's open access tariff as it exists on the Effective Date (CAISO Tariff), unless otherwise defined in the Settlement Agreement or in Attachment A to the Settlement Agreement (Tariff Sheets).

13. According to Section 2.1, effective June 1, 2010 and continuing through December 31, 2011, the calculation of the MUFE charge of CAISO's GMC will not include the inter-scheduling coordinator trades. Further, the MUFE charge will be calculated as the greater of a Scheduling Coordinator's supply schedules and demand schedules (including self-schedules) in the day-ahead market. Section 2.2 states that, to implement the MUFE charge calculation described in Section 2.1 of the Settlement Agreement, the CAISO Tariff shall be revised, effective June 1, 2010, pursuant to Sections 2.2.1 and 2.2.2 of the Settlement Agreement.

14. Section 2.2.1 states that Appendix F, Schedule 1, Part A, Paragraph 7, in its entirety, shall be revised to read as follows:

The rate in \$/MWh for the Market Usage Charge will be calculated by dividing the GMC costs, as determined in accordance with Part C of this Schedule 1, allocated to this service category in accordance with Part E of this Schedule 1, by the annual forecasted total purchases and sales (including out-of-market transactions) of Ancillary Services, Energy, Instructed Imbalance Energy, and net Uninstructed Imbalance Energy (with Uninstructed Imbalance Energy for Participating Intermittent Resources netted over the Trading Month and all other Uninstructed Imbalance Energy being netted within a Settlement Interval) in MWh. A Market Usage Charge rate will be calculated separately for two sets of CAISO Markets: (i) the Ancillary Services and RTM rate will be based on MWh of purchases and sales of Ancillary Services in the DAM, the HASP, and the RTM, MWh of Instructed Imbalance Energy, and

MWh of Uninstructed Imbalance Energy netted over the Settlement Interval; and (ii) the rate for the Day-Ahead Market for Energy will be based on MWh of Day-Ahead Schedules. The rate for the Day-Ahead Market for Energy will be based on the sum, for all Scheduling Coordinators and all Settlement Periods, of the greater of the amount of MWh associated with each Scheduling Coordinator's Day-Ahead Schedule of Supply or the amount associated with its Day-Ahead Schedule of Demand for each Settlement Period.

15. Section 2.2.2 states that, in Appendix F, Schedule 1, Part E, Paragraph 1, the sentence beginning with "MU-FE" and ending with "Day-Ahead Market" shall be revised to read as follows:

MU-FE: This factor is the allocation of costs to the Market Usage Charge as applied to Day-Ahead Schedules. For each Scheduling Coordinator, the charge for the Day-Ahead Market for Energy will be based on the sum, for all Settlement Periods, of the greater of the amount of MWh associated with the Scheduling Coordinator's Day-Ahead Schedule of Supply or the amount associated with its Day-Ahead Schedule of Demand for each Settlement Period.

16. Section 2.3 states that, prior to filing its 2012 GMC or proposing any further changes to the 2010 and 2011 GMC other than the prospective Convergence Bidding Charge Type, CAISO will conduct a cost-of-service study and engage in a stakeholder process to determine the appropriate allocation of the costs of operating CAISO.

17. Section 3.1 states that the Settlement Agreement shall become effective upon issuance by the Commission of a Final Order approving the Settlement Agreement without modification or condition, or, if modified or conditioned, upon its acceptance as so modified by the Settling Parties as provided in Section 4.1.2 of the Settlement Agreement. Section 3.2 states that, for purposes of the Settlement Agreement, a Commission order shall be deemed to be a Final Order when the Commission issues an order approving the Settlement Agreement.

18. Section 4.1.1 states that the CAISO Tariff provisions implementing the terms of the Settlement Agreement shall automatically expire on December 31, 2011, unless extended by a filing under Section 205 of the Federal Power Act. Section 4.1.2 states that, if the Commission, in approving the Settlement Agreement or by taking any other regulatory action, modifies the Settlement Agreement in a manner that materially changes the benefits and burdens negotiated therein, the Settling Parties shall meet and confer within 30 days as to whether all Settling Parties can agree to the modified

Settlement Agreement. If all Settling Parties do not agree, in writing, to the modified Settlement Agreement, then the Settlement Agreement shall terminate.

19. According to Section 4.2, the Settling Parties agree that the Settlement Agreement shall have no precedential value, shall not be cited as precedent, and shall not be deemed to bind any Settling Party (except as otherwise expressly provided for therein) in any proceeding, including any FERC proceeding, except in any proceeding to enforce the Settlement Agreement. The Settling Parties further agree that the Settlement Agreement shall not be deemed to be a “settled practice” as that term was interpreted and applied in *Public Service Commission of the State of New York v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980).

20. Section 4.3 states that the Settlement Agreement shall have no effect on the rights of the Settling Parties, during future proceedings concerning CAISO’s 2012 GMC proposal or any subsequent GMC proposal, to protest CAISO’s proposed allocation of the costs of administering its forward markets and to advocate any alternative allocation. Further, the Settlement Agreement shall have no effect on the rights of the Settling Parties, during future proceedings concerning CAISO’s 2011 GMC proposal or any subsequent GMC proposal, to protest any portion of CAISO’s proposed GMC other than the proposed allocation of the costs of administering its forward markets.

21. According to Section 4.4, the Settlement Agreement is made upon the express understanding that it constitutes a negotiated settlement and, except as otherwise expressly provided for therein, no Settling Party shall be deemed to have approved, accepted, agreed to, or consented to any principle or policy relating to the rates, charges, classifications, terms, conditions, principles, issues or tariff sheets associated with the Settlement Agreement.

22. Section 4.5 states that the exhibits to the Settlement Agreement are integrated into, and shall constitute part of, the Settlement Agreement. According to Section 4.6, the Settling Parties acknowledge and agree that the Settlement Agreement, including the exhibits thereto, constitutes the full and complete agreement of the Settling Parties with respect to the subject matter addressed therein and supersedes all prior negotiations, understandings, and agreements, whether written or oral, between the Settling Parties with respect to the subject matter addressed therein.

23. Section 4.7 represents that the Settling Parties intend for the Settlement Agreement to be subject to the just and reasonable standard of review. According to Section 4.8, the Settling Parties agree that the discussions among them that have produced the Settlement Agreement have been conducted on the explicit understanding that they were undertaken subject to Rule 602(e) of the Commission’s Rules of Practice

and Procedure.¹⁰ The Settling Parties further agree that all offers of settlement, and any comments on such offers, and any discussions among the Settling Parties with respect to the Settlement Agreement are privileged, not admissible as evidence against any participant who objects to their admission, and not subject to discovery.

24. Section 4.9 states that the parties agree that all material subject to the protective order issued in this proceeding shall remain subject to that protective order, except to the extent that the CAISO is permitted to release such material under the terms of the CAISO Tariff.

25. Section 4.10 states that the Settling Parties shall support the Settlement Agreement and shall cooperate in securing Commission acceptance and implementation of the Settlement Agreement. Further, the Settling Parties waive any and all rights to seek rehearing or judicial review of any Commission order(s) approving the Settlement Agreement without modification or condition; provided, however, that if the Commission approves the Settlement Agreement with modifications or conditions, any Party may seek rehearing or judicial review of the Commission order(s) approving the Settlement Agreement solely to challenge the Commission's imposition of such modifications or conditions in order to preserve the terms and conditions of the Settlement Agreement as filed. Notwithstanding any other provision of the Settlement Agreement, no party waives its rights under Section 205 or 206 of the Federal Power Act with respect to any provision of the CAISO Tariff.

26. Section 4.11 states that the headings in the Settlement Agreement are included for convenience only and are not intended to have any significance in interpretation of the Settlement Agreement. Lastly, Section 4.12 states that dispute resolution shall be in accordance with the CAISO Tariff.

COMMENTS

27. On April 12, 2010, CAISO filed initial comments in support of the Settlement Agreement. CAISO also filed the declarations of Mr. Michael K. Epstein and Dr. Lorenzo Kristov as Attachment 1 and Attachment 2, respectively, to its initial comments. CAISO asserts, as supported by the declarations of Mr. Epstein and Dr. Kristov, that the methodology for allocating the MUFE charge in the Settlement Agreement is the same methodology filed by CAISO on October 30, 2009. A summary of CAISO's initial comments is as follows:

28. CAISO states that the Commission set for hearing the issue of whether the proposed methodology was just and reasonable in the December 30, 2009 Hearing Order. The Commission did not find that the proposal was unjust, unreasonable, or

¹⁰ See 18 C.F.R. § 385.602(e).

unduly discriminatory. Rather, the Commission concluded that CAISO had not made a sufficient showing that the methodology was just and reasonable.

29. Subsequently, after settlement discussions, the Settling Parties concluded that the proposal, as filed, provided an appropriate allocation of the costs associated with the MUFÉ services pending a cost-of-service study to be conducted for CAISO's 2012 GMC. CAISO submits that if the Settlement Agreement is uncontested, the Commission should approve it as fair and reasonable and in the public interest. Further, CAISO submits that, if the Settlement Agreement is contested, the Commission should find it just and reasonable based on the additional information provided in the declarations of Mr. Epstein and Dr. Kristov.

30. CAISO states that the functionalization of its costs and the costs' allocation to cost categories and subcategories was detailed in CAISO's February 20, 2008 filing.¹¹ The Commission approved this allocation when it found the GMC just and reasonable.¹² CAISO states that the Settlement Agreement does not propose to change this aspect of the market services-forward energy charge, and no party has filed a complaint to suggest that the cost-of-service support is no longer applicable.

31. CAISO states that one aspect of the billing determinants for the MUFÉ charge is also unchanged by the Settlement Agreement. Inter-scheduling coordinator trades were offset in the calculation of the billing determinant in CAISO's compliance filing as approved by the Commission.¹³ CAISO states that the billing determinant under the Settlement Agreement similarly does not include inter-scheduling coordinator trades and no party has filed a complaint to suggest that intervening events have rendered this exclusion unjust and unreasonable.

32. Therefore, CAISO states that the only question before the Commission is whether revising the billing determinants from the net energy to the greater of the energy included in supply bids or demand bids is just and reasonable. In this regard, CAISO believes that it is important to note that more than one just and reasonable rate

¹¹ See "Revisions to Grid Management Charge" submitted by CAISO under ER08-585-000 (February 20, 2008).

¹² *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,338 (2008). The functionalization and categories are described in the Testimony and Exhibits of Mr. Ben Arikawa, submitted in the February 20, 2008 filing, found at: http://elibrary.ferc.gov/idmws/Doc_Family.asp?document_id=13583234.

¹³ *Cal. Indep. Sys. Operator Corp.*, 128 FERC ¶ 61,021, *reh'g denied*, 129 FERC ¶ 61,293 (2009).

can exist.¹⁴ A utility proposing a rate is not required to demonstrate that its proposal is more reasonable than alternative proposals, but only to show that its proposal yields rates that are just and reasonable.¹⁵ The same principles apply to an offer of settlement. CAISO states that, under the Commission's rules, the Commission need only find that the settlement is just and reasonable as a package. The Commission does not require that an offer of settlement provide the most just and reasonable rate.

33. Significantly, in accepting the existing allocation, the Commission did not demand a detailed evaluation of alternatives for measuring forward energy market activity. CAISO believes that, by stating that it was appropriate that the GMC reflect cost causation¹⁶ and accepting the existing allocation as just and reasonable, the Commission implicitly accepted that the netting methodology generally reflected a Scheduling Coordinator's use of the forward energy markets.

34. In this proceeding, Dr. Kristov explicitly sets forth the reasons that a gross methodology is more just and reasonable than the previously accepted netting methodology. He explains that processing supply bids imposes the same costs on CAISO as processing demand bids.¹⁷ Netting supply and demand fails to reflect that reality. As Dr. Kristov states, "[u]nder netting, the [CA]ISO would charge a scheduling coordinator that cleared ten megawatt-hours of supply in the market based on ten megawatt-hours, but would charge nothing to the scheduling coordinator that cleared five megawatt-hours of supply and five megawatt-hours of demand, even though both scheduling coordinators received equivalent services."¹⁸ Based on these circumstances, CAISO believes that under the current functionalization and categorization of costs, allocating the costs to Scheduling Coordinators according to the sum of supply bids and demand bids – the "gross" methodology – would best align the charges with cost causation. CAISO states that, if all other things were equal, it would support the use of the gross methodology.

¹⁴ See *Cities of Bethany v. FERC*, 727 F.2d 1131, 1138 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 917 (1984); *Ala. Elec. Coop., Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982); *Int'l Transmission Co.*, 123 FERC ¶ 61,065 at P 20 (2008).

¹⁵ See *Transcontinental Gas Pipe Line Corp.*, 87 FERC ¶ 61,087, 61,387-88 (1999); *"Complex" Consol. Edison Co. of New York v. FERC*, 165 F.3d 992, 1003-04 (D.C. Cir. 1999); *Tenn. Gas Pipeline Co.*, 80 FERC ¶ 61,070, 61,224 (1997).

¹⁶ *Cal. Indep. Sys. Operator Corp.*, 125 FERC ¶ 61,338 at P 25 (2008).

¹⁷ See Attachment 2, Declaration of Dr. Lorenzo Kristov on Behalf of CAISO.

¹⁸ *Id.* at P 14.

35. However, CAISO states that a countervailing consideration exists. As documented by Mr. Epstein, the gross methodology would have a very significant cost impact on load-serving entities. Understandably, load-serving entities have expressed strong opposition to the gross methodology, and CAISO is sympathetic to the need to avoid sudden cost increases, particularly during a period of difficult economic times for many ratepayers. CAISO states that this is particularly so when it is planning to conduct a cost-of-service study in 2010 and 2011, for use in the 2012 GMC development, that might yield a revised functionalization and categorization of costs associated with the forward markets.

36. CAISO states that the Settlement Agreement therefore adopts a compromise proposed by Powerex during the stakeholder process: allocation of the charge based on the greater of a scheduling coordinator's total supply schedules or total demand schedules – the “modified gross” methodology. As evidenced by the comments filed in response to the October 30, 2009 filing, the vast majority of the parties accepted this methodology.

37. CAISO believes that, although this methodology may not be the methodology most consistent with cost causation, such fact does not render it unjust, unreasonable, or unduly discriminatory. CAISO cites the Commission's statement:

[C]ost causation principles require that “all approved rates reflect to some degree the costs actually caused by the customer who must pay them.” Compliance with this principle is evaluated “by comparing that costs assessed against a party to the burden imposed or the benefits drawn by that party.” Costs need not be allocated with “exact precision,” and we are not required to reject a rate mechanism simply because that mechanism may possibly track cost causation principles less than perfectly. As the Supreme Court found, “allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science.” “Cost itself is an inexact standard and may, in a particular set of circumstances, serve as a basis for several different rates.” Neither statutes nor court decisions “require the Commission to utilize a particular formula or a combination of formulae to determine whether rates are just and reasonable.”¹⁹

38. CAISO notes that the Commission approved the netting approach as just and reasonable. Dr. Kristov explains why the gross methodology is the most consistent

¹⁹ *San Diego Gas & Elec. Co. v. Sellers of Ancillary Serv.*, 127 FERC ¶ 61250 at P 43 (2009) (footnotes omitted).

with cost causation. Mr. Epstein's declaration demonstrates that the modified gross methodology shifts the allocation significantly from the current net approach to the more causation-consistent gross approach, while providing some mitigation of excessive cost impacts.²⁰ CAISO therefore argues that, if the modified gross approach is more consistent with cost-causation than the current Commission-approved rate, the modified gross approach must be just and reasonable.

39. On April 12, 2010, Staff filed initial comments in support of the Settlement Agreement. Staff believes that the Settlement Agreement represents a fair and reasonable resolution of the disputed issues in this proceeding. Staff states that the Settlement Agreement achieves an interim resolution of the issues set for hearing, pending CAISO's completion of a new cost-of-service analysis in preparation for its 2012 GMC filing. Staff further notes that the Settlement Agreement eliminates the need for any additional expenditure of major financial and personnel resources by the parties and the Commission in this docket.

40. After review of the information exchanged during the settlement process, Staff believes that the information, in conjunction with (i) the fact that sufficient data may not yet be available to perform an accurate cost-of-service study due to the short time that MRTU has been in effect and (ii) the CAISO's commitment to do a detailed cost-of-service study prior to its 2012 GMC filing, supports the use of the Settlement rates during the interim period. Staff concludes that the Settlement Agreement resolves the issues in this proceeding in a manner satisfactory to the Settling Parties, and avoids the expense and delay of litigation. Staff, therefore, requests the undersigned to certify the Settlement Agreement to the Commission for acceptance.

41. On April 12, 2010, Alliance filed initial comments in support of the Settlement Agreement. Alliance supports the removal of the inter-scheduling coordinator trades from the billing determinates in the calculation of the MUFEE charge. Alliance also supports the compromise proposal to apply, on an interim basis, the MUFEE calculation to the "greater of" supply or demand in the day-ahead schedules, and CAISO's commitment to undertake a new cost-of-service study before making additional GMC changes. Therefore, Alliance requests that the Commission expeditiously approve the Settlement Agreement.

42. On April 12, 2010, SWP filed initial comments clarifying its position with regard to the Settlement Agreement. Due to unforeseeable circumstances, SWP filed its initial comments after the 5:00 p.m. Eastern Time filing deadline. Therefore, on April 13, 2010, SWP filed a motion requesting the Commission to allow and accept its initial comments on the Settlement Agreement one day out-of-time.

²⁰ See Attachment 1, Declaration of Mr. Michael K. Epstein at PP 18-26.

43. SWP states that it does not oppose the Settlement Agreement, but submits initial comments to clarify its position. Specifically, SWP supports the GMC structure and supports its extension through 2010, but states that the Existing Transmission Contracts (ETCs) should be exempted from the MUFE charge because the ETCs do not impose costs for energy market transactions on CAISO.

44. During the settlement process, SWP urged that the MUFE modification be revised to exempt the ETCs from the MUFE charge. SWP also expressed this concern during the stakeholder process which culminated in CAISO's filing. SWP notes that the Settlement Offer exempts inter-scheduling coordinator energy trades from the MUFE charge. SWP does not object to this exemption. However, SWP believes that the Settlement Agreement should also exempt ETC transactions because ETCs do not cause CAISO to incur energy market-related costs.

45. SWP believes that the design of the MUFE charge does not accommodate inclusion of ETCs. The MUFE charge applies to market participants who use CAISO market services in the day-ahead market. According to SWP, ETC self-schedules do not use CAISO market services, do not impact the market outcome, and do not benefit from the market. Therefore, SWP concludes that the Settlement Agreement should exclude ETCs.

46. According to SWP, ETCs have many benefits. SWP states ETCs lessen CAISO's need to manage congestion, schedule transmission service, and clear the markets. Assisting CAISO's management of congestion, ETCs specify a particular quantity of transmission service to which the parties to the contract agree, thereby ensuring that the ETC holder does not use all its contracted capacity in the day-ahead market. SWP states that, at this point, the unused capacity is no longer a function of the contract. Therefore, the unused contract amount is available for the CAISO's benefit to mitigate congestion.

47. SWP enumerates several reasons for exclusion of ETCs from the Settlement Agreement. First, the GMC rate structure includes a separate charge for Existing Transmission Service (ETS). The charge for ETS recovers CAISO's costs for scheduling transmission service. The Settlement Agreement includes this charge. SWP therefore concludes that ETC costs caused by transmission services are appropriately recovered through the ETS charge. Second, ETCs do not use the CAISO's MUFE services. CAISO does not need to commit generation units to service ETC demand or to find a demand to consume ETC generation because ETC schedules are balanced. SWP states that, if an ETC holder submits an unbalanced schedule, CAISO will either reject the unbalanced part of the schedule or treat the unbalanced part of the schedule as a non-ETC schedule. Third, SWP states that, while ETC schedules are constraints only when CAISO optimizes the market, ETCs are not part of the CAISO market and do not

benefit from the CAISO market. Fourth, SWP states that, during market settlement, ETC transactions are cost / revenue neutral between Scheduling Coordinators and CAISO. SWP summarizes that ETC energy does not use MUFEE services and that CAISO should not assess any MUFEE charges to ETC energy. Therefore, SWP believes that the Settlement Agreement would have more accurately reflected the principle of cost causation if it excluded ETCs. SWP submitted its initial comments for the purpose of clarifying its position and the record, and for the Commission's consideration. In its April 13, 2010 motion, SWP reiterates that it does not object to or oppose the Settlement Offer, and that no party will be prejudiced by acceptance of the initial comments one day out-of-time.

REPLY COMMENTS

48. On April 22, 2010, CAISO filed reply comments. CAISO argues that no party raised a contested issue of fact or opposed the Settlement Agreement. Accordingly, CAISO requests that the Commission approve the Settlement Agreement as fair and reasonable and in the public interest.

49. CAISO believes that SWP's comments arise from a fundamental misapprehension of the manner in which CAISO processes ETC self-schedules in the new markets. An ETC self-schedule comprises a demand self-schedule and a supply self-schedule. CAISO states that, with only a few exceptions, CAISO's market processes ETC self-schedules in the same manner as other bids. Specifically, the market optimization software treats all submitted supply and demand bids, including self-schedules, as separate "controls", which are transactions that can be adjusted to reach a solution. In running the software, the supply self-schedule and the demand self-schedule within a Scheduling Coordinator's submitted bid are not linked in any way. CAISO notes that clearing the market includes congestion management, clearing energy, and procuring ancillary services – the "integrated" concept behind IFM. CAISO states that, to clear the market, all submitted supply and demand bids and self-schedules, including ETCs, must be taken into account in managing congestion and clearing the energy market. Further, any of them may be adjusted. CAISO therefore argues that ETC self-schedules are very much a part of CAISO's markets and that they cause CAISO to incur market-related costs.

50. CAISO states that its markets treat ETC schedules differently in only two significant instances.²¹ First, CAISO validates ETC schedules before putting them into the market to ensure that they comply with their rights as specified by the relevant

²¹ CAISO notes that, in addition to these differences with respect to running the CAISO markets, existing transmission contracts are treated quite differently in settlements. For example, existing transmission contracts are subject to transmission access charges or congestion charges.

participating transmission owner. Second, the market software provides for an adjustment hierarchy so that the market will try to reach a reasonable solution by adjusting economic bids and non-ETC self schedules, other than reliability must run and transmission ownership rights schedules, before ETC schedules, thus giving ETCs a significant degree of scheduling priority. CAISO states that the two features do not reduce the impact that ETC self-schedules have on the operation of CAISO markets. CAISO therefore argues that the two features do not provide a basis for reducing the exposure of ETC schedules to the MUFE charge.

51. CAISO argues that no basis exists for SWP's argument that ETCs assist CAISO in managing congestion. According to CAISO, SWP contends that ETCs specify a particular quantity of transmission service to which the parties to the contract agree, thereby ensuring CAISO that the ETC holder cannot request more than specified in the contract. CAISO states that an ETC does nothing of the sort. An ETC holder will schedule more or less than the ETC capacity according to its load needs and its supply availability. The only constraint imposed by the ETC is a limit on the amount that can be scheduled under the terms of the ETC rights, which provide the scheduling priority and exemption in settlement from transmission access and congestion charges. CAISO states that its software systems must include validation rules and procedures because Scheduling Coordinators for holders of ETC rights can submit self-schedules in quantities that exceed the megawatt hour amount of their rights.

52. CAISO states that SWP also argues that, to the extent that an ETC holder does not use all of its contracted capacity in the day-ahead market, the unused contract amount could be freed up for CAISO's benefit in mitigating congestion. CAISO responds that this is not an advantage of ETCs. Rather, this fact only puts ETC schedules on a more comparable footing to other schedules in terms of the congestion management burden imposed on CAISO. CAISO states that, prior to its comprehensive market redesign, its inability to schedule on unused ETC capacity significantly complicated congestion management by causing "phantom congestions."²² CAISO argues that, by providing that CAISO could schedule on the unused capacity, the market reforms simply eliminated a problematic and unnecessary burden.

53. Further, CAISO argues that special treatment of ETC self-schedules actually adds to the cost of operating CAISO's forward markets. CAISO states that additional resources are necessary to perform additional validation steps required to ensure the compliance of submitted ETC self-schedules with the parameters of their actual rights. CAISO also states that the need to enforce a complicated hierarchy of scheduling priorities makes the software more complicated and reduces the efficiency of market solutions. CAISO therefore argues that no merit exists to the argument that ETC self-schedules do not affect the costs of operating the CAISO's forward market.

²² See, e.g., *Cal. Indep. Sys. Operator Corp.*, 109 FERC ¶ 61,301 at PP 17-21 (2004).

Accordingly, CAISO believes that its proposal to allocate the MUFE charge based on all market energy schedules, including ETC schedules, is just and reasonable. Finally, CAISO requests the Commission to approve the Settlement Agreement.

54. On April 22, 2010, Staff filed reply comments in response to SWP's initial comments. Staff notes that SWP does not oppose the Settlement Agreement. Staff states that ETC customers are not exempt from paying various GMCs simply by virtue of being served under an ETC. Staff asserts that the Commission addressed this issue in Opinion No. 463.²³ Staff also argues that SWP's specific claim – the Settlement Agreement would have more accurately reflected cost causation had it included an accommodation for ETCs – has no support. Further, Staff does not take a position regarding SWP's claim. Staff notes that Article II of the Settlement Agreement provides that CAISO will perform a full cost-of-service study to determine the appropriate allocation of the costs of operating the CAISO for its 2012 GMC. Staff accordingly believes that SWP's concerns will be addressed at the time of the cost-of-service study. Staff reiterates its belief that the Settlement Agreement is a reasonable resolution of the issues presented in this proceeding. Therefore, Staff requests the undersigned and the Commission to disregard SWP's initial comments pertaining to an ETC exemption. Finally, Staff states that the Settlement Agreement may be certified and accepted as uncontested because it is not opposed.

DISCUSSION

55. The Settlement Agreement resolves all issues set for hearing and settlement judge procedures in the Hearing Order. Pursuant to the Chief Judge's notice requesting that parties include certain information in all offers of settlement,²⁴ the Settling Parties have discussed various policy considerations.

56. The factual and procedural background of this proceeding, the issues underlying this proceeding, and the major implications of this proceeding have been summarized in Sections 1 and 2 of the Settlement Agreement. The Settling Parties expressly agree that this is a negotiated settlement, that its terms set no precedent regarding future rates, and that during proceedings on the CAISO's proposal for its 2012 GMC, parties retain the right to protest CAISO's proposed allocation of the costs of administering its forward market and to advocate a different allocation.

²³ Opinion No. 436, 103 FERC ¶ 61,114 at PP 47-58 (2003); Opinion No. 463-A, 106 FERC ¶ 61,032 (2004).

²⁴ See "Notice to the Public – Information to be Provided with Settlement Agreements," (issued October 15, 2003); "Errata," (issued October 23, 2003).

57. The Settlement Agreement furthers the broad public interest favoring settlements.²⁵ Beyond that, the Settlement Agreement does not raise policy implications.
58. The Settlement Agreement does not affect any other pending cases.
59. The Settlement Agreement involves no issues of first impression, and there are no previous reversals on the issues involved in this proceeding.
60. The just and reasonable standard of review applies to modifications of the Settlement Agreement.

CERTIFICATION

61. Accordingly, pursuant to 18 C.F.R. § 385.602 (g) (1) (2009), the undersigned hereby certifies to the Commission the following documents:
- (a) Transmittal Letter filed March 23, 2010;
 - (b) Offer of Settlement, including the tariff sheets implementing the Offer of Settlement (Attachment A) and the black-lined versions of the tariff sheets (Attachment B), filed March 23, 2010;
 - (c) Explanatory Statement in Support of Offer of Settlement filed March 23, 2010;
 - (d) Draft Commission Order Approving the Settlement filed March 23, 2010;
 - (e) Initial Comments of the California Independent System Operator Corporation in Support of the Offer of Settlement filed April 12, 2010;
 - (f) Initial Comments of the Commission Trial Staff in Support of Offer of Settlement filed April 12, 2010;
 - (g) Initial Comments of the Alliance for Retail Energy Markets on Offer of Settlement filed April 12, 2010;
 - (h) Initial Comments of the California Department of Water Resources State Water Project's filed April 12, 2010;

²⁵ See *Southern Union Gas Co. v. FERC*, 840 F.2d 964, 971 (D.C. Cir. 1988).

- (i) Motion of the California Department of Water Resources State Water Project to File Comments on Proposed Settlement One Day Out-Of-Time filed April 13, 2010;
- (j) Reply Comments of the California Independent System Operator Corporation in Support of Offer of Settlement filed April 22, 2010; and
- (k) Reply Comments of the Commission Trial Staff filed April 22, 2010.

Judith A. Dowd
Settlement Judge

DRAFT

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

In Reply Refer to:
Docket No. ER10-188-000

Michael E. Ward
Counsel for California Independent System Operator Corporation
Alston & Bird LLP
The Atlantic Building
950 F Street, N.W.
Washington, D.C. 20004-1404

Dear Mr. Ward:

1. On March 23, 2010, you filed on behalf of the California Independent System Operator Corporation (CAISO), Calpine Corporation, Citigroup Energy, Inc., Dynegy Morro Bay, LLC, Dynegy Moss Landing, LLC, Dynegy Oakland, LLC, and Dynegy South Bay, LLC, Morgan Stanley Capital Group, Inc., Pacific Gas and Electric Company, Powerex Corp., San Diego Gas & Electric Company, and Southern California Edison Company a proposed Offer of Settlement (Settlement Agreement) in the above-referenced proceeding. On April 12, 2010, CAISO, Commission Trial Staff (Staff), and the Alliance for Retail Energy Markets (Alliance) filed initial comments in support of the Settlement Agreement. The California Department of Water Resources State Water Project (SWP) filed initial comments after the 5:00 p.m. Eastern Time deadline on April 12, 2010 and a motion requesting the Commission to accept its comments one day out-of-time on April 13, 2010. SWP does not oppose the Settlement Agreement, but rather submitted initial comments to clarify its position and the record. On April 22, CAISO and Staff filed reply comments in support of the Settlement Agreement. On May 5, 2010, the Settlement Judge certified the Settlement Agreement to the Commission as an uncontested settlement.

2. The Settlement Agreement resolves all issues set for hearing in the above-referenced proceeding. Further, the Settlement Agreement is in the public interest and is hereby approved. However, the rate schedule designations shown on the revised tariff pages do not comply with Order No. 614. *See Designation of Electric Rate Schedule Sheets*, Order No. 614, 65 Fed. Reg. 18,221, (FERC Statutes and Regulations, Regulations Preambles July 1996 – December 2000 ¶ 31,096 (2000)). Therefore, CAISO is required to file rate schedule sheets in conformance with Order No. 614 within 30 days of this order approving the settlement.

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3. The Commission's approval of the Settlement Agreement does not constitute approval of, or precedent regarding, any principle or issue in this proceeding. The Commission retains the right to investigate the rates, terms, and conditions under the just and reasonable and not unduly discriminatory or preferential standard of Section 206 of the Federal Power Act, 16 U.S.C. § 824e.

4. This letter terminates Docket No. ER10-188-000.

By direction of the Commission.

Kimberly D. Bose
Secretary

cc: All parties of record

Document Content(s)

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