



September 20, 2002

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

**Re: California Independent System Operator Corporation
Docket No. ER02-1656-000
Docket No. ER02-1637-000
Docket No. ER02-____-000
Update To The Comprehensive Market Design Proposal
And Request For Expedited Consideration**

Dear Secretary Salas:

Pursuant to Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d, Section 35.13 of the Federal Energy Regulatory Commission's ("Commission") regulations, 18 C.F.R. § 35.13, and Rules 212 and 2008(a) of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.2008(a) (2002) the California Independent System Operator Corporation ("ISO")¹ hereby submits for filing an original and six copies of its Update to the Comprehensive Market Design ("MD02") proposal contained in Amendment No. 44 to the ISO Tariff ("Update") and Request for Expedited Consideration of the Update. For the reasons described below, the ISO respectfully submits that good cause exists for the Commission to undertake expedited action on and grant approval of the proposed clarifications and modifications set forth herein. This Update would modify the ISO Tariff to: (1) postpone the effective date for the implementation of Real-Time Economic Dispatch and Uninstructed Deviation Penalties; (2) change the deadline for submitting Supplemental Energy bids; (3) exempt bids \$0/MWh or less from the calculation to determine the reference price for resources; (4) extend the provisions of ISO Tariff Amendment No. 43 to pay pre-dispatched System Resources outside the ISO Control Area the instructed Imbalance Energy price in all intervals; (5) clarify that Automatic Mitigation Procedure reference prices will be calculated daily; and (6) limit the liability of the independent entity calculating such reference prices.

These changes are necessary to implement the new MD02 elements on October 1, 2002, following the expiration of the current market power mitigation provisions. The changes also are necessary to reflect changes in implementation timing of certain MD02 features scheduled beyond October 1, 2002. Each of the proposed changes is the result of further ISO

¹ Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, Appendix A to the ISO Tariff, as filed August 15, 1997, and subsequently revised.

and stakeholder consideration of the details of proposals presented by the ISO when it filed its initial MD02 Tariff Amendment No. 44 in Docket Nos. EL00-95 and ER02-1656 on May 1, 2002 (as supplemented by filings submitted by the ISO in those same dockets on June 17 and June 28, 2002) ("May 1 MD02 Filing"), has arisen as a result of modifications the Commission ordered in its July 17, 2002 order on the May 1 MD02 Filing,² or reflects updated time schedules for implementing various elements of MD02.

I. PROPOSED TARIFF REVISIONS

A. Postponed Effective Date for Implementation of Real-Time Economic Dispatch³ and Uninstructed Deviation Penalties

On May 1, 2002, as part of its initial MD02 submission, the ISO filed to implement Real-Time Economic Dispatch and Uninstructed Deviation Penalties effective October 1, 2002. In approving the ISO's proposed Uninstructed Deviation Penalties, the Commission conditioned implement of the proposed penalty provisions upon the "successful and tested implementation of [] software improvements" that "receive and incorporate communications on outages, derates, and operating problems in real-time" and "allow more accurate representation of ramp rates at various operating points of a unit." July 17, 2002 Order at ¶141.

Accordingly, prior to implementation of Uninstructed Deviation Penalties, the ISO must ensure software is tested and implemented which will: (1) allow Market Participants to notify the ISO of operating limitations in real time (an extension of the existing "SLIC" application)⁴ and (2) allow the ISO's Master File to recognize more than one ramp rate for a single resource.⁵ The ISO currently estimates that these software modifications will not be ready until the first quarter of 2003.

In its July 17, 2002 Order at ¶ 128, the Commission provided that "[w]e will accept the CAISO's proposal to implement software that uses real-time economic dispatch to clear 'Price Overlap' problems." However, based upon prior experience, the ISO believes it cannot have a successful implementation of Real-Time Economic Dispatch, through a single Imbalance Energy price, unless the ISO also implements Uninstructed Deviation Penalties. In the past, Generators' adherence to ISO Dispatch instructions was notoriously poor under the prior single Imbalance Energy price regime, and the ISO strongly believes that the Uninstructed Deviation Penalties are necessary to prevent that problem from reoccurring. Moreover, as detailed *supra*, the Commission has conditioned use of Uninstructed Deviation Penalties upon implementation of two complex new software programs, that the ISO cannot test and

² *California Independent System Operator Corporation*, 100 FERC ¶ 61,060 ("July 17, 2002 Order").

³ Real-time economic dispatch replaces the current methodology for clearing any "price overlap" of incremental and decremental bids (by establishing a "target price") with a system that dispatches overlapping bids, yielding a continuous monotonically increasing Supplemental Energy supply curve and a single Imbalance Energy price instead of the existing Instructed and Uninstructed Imbalance Energy prices.

⁴ "SLIC" stands for Scheduling and Logging for the ISO of California – the application used by the ISO for real-time operations logging.

⁵ Ramp rates for many, if not most, generating units vary with the unit's operating level.

implement until the first quarter of 2003. The ISO, therefore, proposes to postpone to the first quarter of 2003 the effective date for implementation of Real-Time Economic Dispatch such that the Uninstructed Deviation Penalties can also be put into effect. To effect these necessarily coordinated implementation dates, the ISO is filing new Tariff sheets concerning these elements to permit them to become effective ten days after the ISO notifies the Commission and Market Participants that the required software modifications are complete and have been successfully tested with Market Participants.

B. Changed Deadline for Submitting Supplemental Energy Bids

The ISO Tariff Section 2.5.22.4.1 presently sets the deadline for submitting Supplemental Energy bids for the next hour's real-time market at 45 minutes before the start of that hour. Once the bids are received, the ISO must: (1) review the Supplemental Energy "stack" of bids submitted from both within the ISO Control Area and from outside the ISO Control Area (*i.e.*, System Resources, which includes interties); (2) compare the next hour's forward Load Schedules with the ISO's Load forecast to estimate how much of the Supplemental Energy stack must be Dispatched in the next hour; (3) pre-dispatch the System Resources; and (4) verify the resulting inter-control area Schedules with the other control areas. All of these activities must be completed by 30 minutes prior to the next operating hour in accordance with standard Western Electricity Coordinating Council ("WECC") practice.

On October 1, 2002, the ISO will subject all Supplemental Energy bids to the AMP as approved by the Commission in its July 17, 2002 Order at ¶ 65. Thus the ISO now will perform a fifth time-consuming step in the period between the deadline for submission of Supplemental Bids and the start of the operating hour. The processing time that the new AMP software requires significantly reduces the amount of time the ISO currently has to review the Supplemental Energy stack, pre-dispatch Supplemental Energy interchange bids and verify inter-control area schedules by thirty minutes past the hour. The ISO cannot accomplish all of these steps if Supplemental Energy bids can continue to be received until 45 minutes prior to the operating hour. To allow time for the AMP, the ISO proposes to move the deadline for submitting Supplemental Energy bids from 45 minutes to 60 minutes prior to the operating hour.

This change of 15 minutes is consistent with the ISO's Phase II MD02 proposal, filed on June 17, 2002 in the above-referenced dockets, for implementation in Spring 2003, to reform the current real-time and Hour-Ahead market timelines.

Accordingly, the ISO proposes to modify ISO Tariff Section 2.5.22.4.1 and Dispatch Protocol Section 7.3 to change the deadline for submitting Supplemental Energy bids from 45 minutes before the operating hour to 60 minutes before the operating hour.

C. Exempting Incremental Energy Bids Priced \$0/MWh or less from the Reference Price Calculation

Under the market power mitigation provisions imposed by the Commission in its December 19, 2001 Order,⁶ marketers and System Resources (System Resources include interties and resources outside the ISO Control Area) participating in the ISO Imbalance Energy Markets, unless otherwise eligible to set the Market Clearing Price ("MCP"), were limited to bids of \$0/MWh into those real-time Markets. This provision, along with most of the other requirements under the Commission's market power mitigation program, will expire on September 30, 2002, and this specific provision will be replaced in part by the new AMP. However, as set forth in the ISO Tariff Section Market Monitoring and Information Protocol ("MMIP") Section 3.1.1.1(a)(2), the first (preferred) method that is to be used for calculation of AMP reference prices is to take the lower of the mean or median of bids accepted by the ISO over the previous 90 days. Application of this first step of the AMP process to System Resources, which have been required to bid at \$0/MWh since December 19, 2001, would mean that reference prices for such resources would be set at \$0/MWh on October 1, 2002. Accordingly, method number 4, as set forth in MMIP Section 3.1.1.1(a)(2) will be used. This method provides that reference prices for units for which data to employ methods 1, 2, 3 in that same section are lacking, will be calculated using the "mean of the Economic Market Clearing Prices for the units' relevant location (zone or node commensurate with the pricing granularity in effect) during the lowest-priced 25 percent of the hours that the unit was dispatched or scheduled over the previous 90 days for peak and off-peak periods, adjusted for changes in fuel prices; . . ." After October 1, 2002, bids accepted by the ISO will serve as the basis for calculating reference prices for System Resources, consistent with the calculation for other units that do have historical, non-\$0/MWh bids for the period of up to ninety days before October 1, 2002.

Moreover, the ISO herein clarifies that no incremental Energy and capacity bids of \$0/MWh or less (*i.e.*, negative amounts), whether accepted before, on or after October 1, 2002, will be eligible for consideration in calculating reference prices for any generation resource within or outside the ISO Control Area. Incremental Energy and capacity bids of \$0/MWh or less represent a willingness to supply as a price-taker in the ISO markets. It is reasonable, therefore, to exclude these bids from the reference level calculation. Potomac Economics, Ltd., the independent entity under contract with the ISO to calculate reference prices has recommended to the ISO this exclusion of \$0/MWh or less bids. See Attachment E hereto.

The ISO proposes to modify Section 3.1.1.1 of Appendix A of the Market Monitoring and Information Protocol ("MMIP") to implement these changes.

D. Extension of the Provisions of Amendment No. 43

Prior to implementation of Amendment No. 43, the ISO settled with each Scheduling Coordinator for Instructed Imbalance Energy based on the Market Clearing Price for each ten-

⁶ 97 FERC ¶ 61,275 (2001), ("December 19, 2001 Order").

minute transaction interval and paid each Scheduling Coordinator the less-favorable Uninstructed Imbalance Energy price for Energy delivered in each interval that was not instructed by the ISO. This meant that System Resources, generally able to make hourly Schedule changes only and so unable to respond to ten-minute Dispatch instructions from the ISO, were settled at the Uninstructed Imbalance Energy price for those intervals that the ISO “reverses” or “un-Dispatches” them. This practice resulted in decreased participation by out-of-state suppliers in the ISO Markets – a trend of significant concern to the ISO because imported Energy is a critical contribution to the total electricity supply required to serve California Load.

The Commission’s December 19, 2001 Order, as discussed *supra* in Section C, mandated that System Resources bid \$0/MWh into the ISO Markets to mitigate concerns about megawatt laundering.⁷ Out of a concern that the \$0/MWh bidding requirement would further discourage System Resources from offering their power to California during the summer peak demand season, the ISO filed proposed Amendment No. 43 on April 24, 2002. As approved by the Commission on June 11, 2002,⁸ Amendment No. 43 provided that suppliers of imported Energy would be paid the Instructed Imbalance Energy price in all intervals within an hour.⁹ In adopting Amendment No. 43, the Commission found that “this amendment allows for settlement procedures for System Resources that are different from those applied to in-state generators [because] these generators are differently situated (they schedule on an hourly, rather than ten-minute basis, and may not be able to respond to ISO reduction requests). . . .” 99 FERC ¶ 61,296, slip op. at 3. Amendment No. 43 also included a provision that would automatically sunset its provisions when the Commission price mitigation expired on September 30, 2002.

When the \$0/MWh bidding requirement expires on September 30, 2002, imported Energy suppliers can again bid an amount other than \$0/MWh and again can set the ISO’s Imbalance Energy price if they are the marginal resource dispatched by the ISO. However, they will also again be subject to receiving the less-favorable Uninstructed Imbalance Energy price in those intervals in which their pre-dispatched Energy is not required by the ISO. To address this concern and provide a greater incentive for imports to participate in the ISO Markets, the ISO proposes to extend the provisions of Amendment No. 43 to pay suppliers of imported Energy the Instructed Imbalance Energy price in all intervals within an hour to

⁷ “Megawatt laundering” is the practice of exporting power from California to an adjacent control area, then selling it back to California at a higher price outside the market to avoid a price cap on California markets. The west-wide \$250/MWh price cap to be implemented October 1, 2002 discourages megawatt laundering because it sets a uniform maximum price on all sales in the WECC region, including California.

⁸ *California Independent System Operator Corporation*, 99 FERC ¶ 61,296 (2001).

⁹ At the time the ISO filed Amendment No. 43, the ISO was optimistic, based on discussions at some technical conferences, that the Commission would rescind the \$0/MWh requirement. The Commission declined to do so, however, in its May 15, 2002 Order (*San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 99 FERC ¶ 61,158) on the ISO’s January 25, 2002 compliance filing submitted in response to the Commission’s December 19, 2001 Order (*San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 97 FERC ¶ 61,275).

encourage imports to continue to offer Energy to California. This proposal will not “stick” the Imbalance Energy price at the level of the highest-priced pre-dispatched intertie bid for the full hour. To implement this modification, the ISO proposes to amend Section 11.2.4.1 of the ISO Tariff to remove the expiration-date language from the section.

E. Clarification That Reference Prices Will Be Calculated Daily And The Gas Proxy Price Will Be Monthly

The ISO proposes to clarify that the ISO intends to update AMP reference prices daily. To that end, the ISO herein includes proposed modification text to MMIP Section 3.1.1.1, ISO Tariff Appendix A, to specifically state that reference prices will be updated daily.

Additionally, the ISO notes that it has always intended to use monthly bid week gas prices for determining the reference prices for gas-fired units that do not have sufficient bid histories. Thus, the ISO has always intended to use the same proxy prices for natural gas for purposes of the AMP reference prices as the Commission has already approved for use in calculating proxy prices under the Commission’s market power mitigation period. Moreover, this will be consistent with the ISO’s continuing use of such monthly bid week gas prices to calculate proxy prices for available capacity for generating units under the Must Offer Obligation. Moreover, the Commission has rejected the use of a daily index (rather than a monthly index) on several occasions and, as a result, the ISO neither contemplated nor proposed use of a daily gas price for the AMP reference prices. See 95 FERC ¶ 61,418 (2002) at 62,561; 97 FERC ¶ 61,293 (2001) at 62,204. Therefore, in an abundance of caution, the ISO proposes to clarify that monthly gas prices will be used for the reference price calculations developed each day within the relevant month.

F. Limitation of the Liability of the Independent Entity Calculating Reference Prices

As directed by the Commission, the ISO entered into a contract with an independent entity that will calculate reference prices to be used in the AMP. This entity, as the Commission was informed on September 16, 2002, is Potomac Economics, Ltd. (“Potomac”). Potomac indicated to the ISO that it will not perform the work unless it is held harmless from any damages that might arise as a result of the reference prices it calculates unless Potomac is found to have been negligent or to have engaged in intentional wrongdoing. The ISO notes that such liability protection is the same that the ISO would have under the existing ISO Tariff under Section 14.1 if it were to perform this work itself. Thus, the ISO is not proposing a change in the amount of protection, only an extension of that protection to the subcontractor that will undertake this activity for the ISO Markets in accordance with the Commission’s directive. Moreover, Potomac provides similar AMP consultation services to the New York Independent System Operator and is the beneficiary of a similar hold harmless provision with that independent system operator as well. Moreover, the ISO believes that without such indemnification, the independence of the independent entity could be compromised as decisions in determining reference price levels may be influenced by concerns over potential litigation.

Potomac and the ISO agreed to a provision in Potomac's Consultant Agreement directing the ISO to submit for ISO Governing Board approval a Tariff amendment stating that Potomac will not be liable for damages to any Market Participant arising from Potomac's calculation of the reference prices except if those damages result from Potomac's negligence or intentional wrongdoing. The Board approved such a provision on September 19, 2002.

Accordingly, this change is reflected in proposed new Section 14.4 to the ISO Tariff.

II. REQUEST FOR EXPEDITED CONSIDERATION AND EFFECTIVE DATES

Given the critical deadlines for the several aspects of MD02 detailed herein, the ISO respectfully requests that all proposed Tariff modifications and clarifications, with the exception of the provisions governing Real Time Economic Dispatch and Uninstructed Deviation Penalties (Appendices G and I to the May 1 MD02 Filing, respectively) become effective on October 1, 2002. Moreover, the ISO respectfully requests that the proposed timing for Real Time Economic Dispatch and Uninstructed Deviation Penalties become effective upon notice from the ISO to the Commission and ISO Market Participants as evidenced by a letter from the ISO to the Commission and a Market Notice issued by the ISO.

The ISO notes that, due to concerns about implementing the AMP without sufficient testing, concurrently with the instant filing it is filing an Emergency Motion for Limited Extension of Current Price Mitigation Regime and Request For Expedited Consideration. The Emergency Motion seeks a limited extension of no more than 30 days of the existing price mitigation regime established in the West to enable the ISO to complete development and thorough testing of the AMP. Because of the imminent deadlines, the ISO requests expedited consideration of that motion. If the Commission grants the requested extension of the existing price mitigation regime, the ISO respectfully requests that the Commission defer the effective date of the provisions of this filing which the ISO is asking to implement on October 1, 2002, until the day after the extended price mitigation expires.

To the extent necessary, the ISO request waiver of the prior notice provisions of Section 205(d) of the FPA, 16 U.S.C. § 824(d), and Section 35.3 of the Commission's regulations, 18 C.F.R. § 35.3, to permit these Tariff revisions to be made effective upon the dates requested *supra*.

III. COMMUNICATIONS

Communications regarding this filing should be addressed to the following individuals, whose names should be placed on the official service list established by the Secretary with respect to this submittal:

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Margaret A. Rostker
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IV. SERVICE

The ISO has served this filing on the Public Utilities Commission of the State of California, the California Energy Commission, the California Electricity Oversight Board, and all parties with effective Scheduling Coordinator Service Agreements under the ISO Tariff. In addition, the ISO has posted a copy of the filing on its Home Page.

V. SUPPORTING DOCUMENTS

The following documents, in addition to this transmittal letter, support this filing:

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| Attachment A | Revised Tariff sheets to reflect the postponed effective date for the Tariff and Protocol Sections described in Section I (A) above. |
| Attachment B | Revised Tariff sheets to reflect the Tariff and Protocol changes described in Section I(B) through (F) above. |
| Attachment C | Sheets showing, in black-line format, the postponed effective date for the Tariff and Protocol Sections described in Section 1(A) above. |
| Attachment D | Sheets showing, in black-line format, the Tariff and Protocol changes described in Section 1(B) through (F) above. |
| Attachment E | Letter from Potomac Economics, Ltd. |
| Attachment F | A form notice of filing suitable for publication in the Federal Register, as well as a computer diskette containing the notice of filing in WordPerfect format. |

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An additional copy of this filing is enclosed to be date-stamped and returned to our messenger. If there are any questions concerning this filing, please contact the undersigned.

Respectfully submitted,

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Enclosures