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VIA ELECTRONIC POSTING

April 10, 2006

Office of the Secretary
Docket Room
Federal Energy Regulatory Commission
888 First Street, N.E., Room 1A, East
Washington, D.C. 20002

**Re: *California Independent System Operator Corporation*, Docket No. ER06-615-000,
Notice of Intervention, Limited Protest, and Comments Of The California Public
Utilities Commission On The California ISO's MRTU Tariff**

Dear Ms. Salas:

Attached for filing in the above-docketed case, please find an electronic version of the above-referenced document.

Thank you for your cooperation in this matter and please do not hesitate to contact me at the phone number or e-mail address below if you have any questions or concerns regarding the foregoing.

Sincerely,

/s/ TRACI BONE

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Enclosure

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System)
Operator Corporation)
_____)

Docket No. ER06-615-000

**NOTICE OF INTERVENTION, LIMITED PROTEST,
AND COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES
COMMISSION ON THE CALIFORNIA ISO'S MRTU TARIFF**

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This Notice of Intervention serves to make the CPUC a party to this proceeding.

II. COMMENTS AND LIMITED PROTEST

A. Overview

On February 9, 2006, the California Independent System Operator Corporation (“CAISO”) filed its “Electric Tariff Filing to Reflect Market Redesign and Technology Upgrade” (“MRTU Tariff Filing”). The MRTU Tariff Filing, including supporting documentation, is over 4,000 pages long. Thus, the CPUC’s protest and comments are necessarily limited to key issues of concern to the CPUC.

As FERC should be well aware, the CPUC generally supports CAISO market redesign and believes that it is critical to California’s energy future. The CPUC has been integrally involved with most aspects of the development of the Market Redesign and Technology Upgrade (“MRTU”), and it has both agreed and disagreed with many specific aspects of MRTU over its more than four-year history. Significantly, throughout this time, the CPUC has consistently premised its support for MRTU, and the move to locational marginal pricing (“LMP”), on the following basic principles:

- Meaningful local market power mitigation (“LMPM”) mechanisms that will protect California ratepayers from the exercise of market power in local areas;
- Settlement of energy charges to load based on load aggregation point (“LAP”) prices averaged over three LAP “zones” that mirror the three largest investor-owned utility (“IOU”) service territories. This is necessary to prevent discrimination among prices charged to retail load because of historic transmission system design, which never contemplated an LMP framework;
- Appropriate allocation of congestion revenue rights (“CRRs”) to load serving entities (“LSEs”) to ensure that they have a reasonably effective hedge against congestion charges under a LMP framework; and
- An understanding that MRTU would respect state authority over energy procurement and work in coordination with the CPUC’s resource adequacy (“RA”) program.

The California electric market is unique in terms of its nearly devastating crisis of 2000 and 2001 and its current market conditions, which include a lack of excess capacity and a highly congested transmission network. These unique factors require that the MRTU not be a mirror of what has been implemented in PJM or the New York ISO markets. Some variation is appropriate, and necessary.

With these concerns in mind, the CPUC supports the vast majority of the MRTU Tariff Filing and urges the Commission to approve many of its key elements in a timely manner. However, some revisions are necessary. Consequently, the CPUC urges the Commission to act no later than June 2006 on the MRTU Tariff so that MRTU can move forward consistent with the project schedule. However, FERC should not approve the MRTU Tariff without modification, and with an effective date of November 1, 2007, as requested by the CAISO. Rather, FERC should approve the CAISO’s proposed effective date for the MRTU Tariff, contingent upon a compliance filing that incorporates certain modifications to the MRTU Tariff; the CAISO should be directed to develop additional Tariff Language, as discussed more specifically below.

As FERC is aware, during MRTU development, the need for a state-mandated RA program became evident. The CPUC committed itself to development of such a program, to be imposed on CPUC-jurisdictional load serving entities (“CPUC-LSEs”). CPUC-LSEs serve approximately 93% of the load in the CAISO’s control area.¹ The CPUC is pleased to report that its RA program is in its initial implementation phase, and that resources procured pursuant to the CPUC’s RA program will be made available to the CAISO to meet 115% of each CPUC-LSE’s forecasted load starting June 1 of this year.

As a result of the imminent effectiveness of the CPUC’s RA program (implementation was accelerated from a projected date of 2008 to June 1, 2006), the CPUC’s most recent concerns with MRTU have focused on ensuring that the MRTU Tariff is complementary to the CPUC’s RA program, and strikes the appropriate balance between CPUC and CAISO responsibilities. While the MRTU Tariff has achieved this goal in some places (such as § 40.6’s focus on RA resource obligations to the CAISO), it has failed in others. Significantly, many provisions of § 40 create confusion for LSEs regarding the proper roles of the CAISO and the CPUC with regard to RA requirements and enforcement. For example, notwithstanding the CAISO’s lack of jurisdictional authority over LSE procurement, § 40.3 establishes local RA procurement requirements for LSEs, and grants the CAISO unlimited procurement authority to meet deficiencies if LSEs do not demonstrate compliance with those requirements. Section 42 further implements this unlimited backstop procurement role for the CAISO.

¹ According to the California Energy Commission, non-CPUC LSEs account for almost approximately 6-7% of CAISO control area load, as measured by August 2006 peak forecasts.

These provisions of the MRTU Tariff are very troubling to the CPUC because, among other things, they have the potential to undermine the CPUC's RA program. Consequently, as described in further detail in Section II.E below, the CPUC requests that FERC reject these portions of the MRTU Tariff, (specifically identified below) and order the CAISO to engage in stakeholder discussions to develop more appropriate tariff provisions that respect state authority over energy procurement.

As reflected in these comments, much work remains to be done before MRTU can be implemented; however, it can be done. None of the objections voiced by the CPUC reflect issues that will interfere with the CAISO's path towards November 2007 implementation; they are simply important details that must be addressed and properly addressed in a modified MRTU Tariff. The CPUC is committed to MRTU, and to the principle that "the perfect should not be the enemy of the good." However, as discussed in further detail below, several provisions of the MRTU require further consideration.

B. The CPUC Supports the Market Power Mitigation Provisions of the Tariff

1. CPUC Support for MRTU Remains Conditioned on Adequate Local Market Power Mitigation ("LMPM")

The CPUC strongly supports the MRTU Tariff's local market power mitigation ("LMPM") provisions, which are modeled after the procedures in place in the PJM market. Adequate and effective LMPM is a pre-condition to the CPUC's support of LMP pricing in the CAISO markets. The CPUC appreciates that the CAISO Management and Board of Governors share this commitment to strong and effective LMPM. As described in the CAISO testimony:

Effective local market power mitigation is the cornerstone of the [market power mitigation] proposal. In fact, the CAISO Management and Board

of Governors conditioned their support for going forward with a market design based on Locational Marginal Pricing (“LMP”) on having strong and effective measures for addressing local market power. While other financial risks that LSEs face can be more easily managed, the market effects of local market power are not as easily hedged and may be pervasive, propagating excess costs on LSEs and ultimately ratepayers. A stringent and effective mechanism for mitigating the exercise of local market power is critical to ensuring efficient market dispatch and pricing.²

Meaningful LMPM is vital to the CPUC’s resource adequacy efforts, particularly the requirement that CPUC-LSEs procure local area resources. Without strong LMPM, sellers with local market power may attempt to exercise such power against the LSEs in the resource adequacy bilateral contracting process.

The CAISO correctly asserts that effective LMPM measures are critical to providing consumers and state policy makers the assurance that California markets will not be subject to market manipulation when MRTU, with LMP, is implemented.³ This assurance is critical to many California parties’ support of the move to LMP. The proposed LMPM mechanisms provide necessary safeguards given California’s tragic history with restructured energy markets and the nature of the CAISO-controlled grid, which is riddled with load pockets which create opportunities for the exercise of local market power when LMP is in place. As discussed in more detail below, the MRTU Tariff’s LMPM provisions are based on FERC precedent and strike the appropriate balance as the CAISO moves to implement LMP. Significantly, this “balance” is not as conservative as it might have been. The CPUC notes that PJM initiated its LMP market with cost-based bids, and eventually transitioned to market-based bids. MRTU will open with market-based bids, further solidifying the immediate need to concurrently

² MRTU Tariff Filing, Attachment K, at 4-5.

implement meaningful LMPM mechanisms. Consequently, the CPUC recommends that FERC adopt the CAISO's LMPM proposal without substantive change.

2. The CPUC Strongly Supports MRTU's Reliance on the FERC-Approved PJM-Style LMPM

The CPUC continues to strongly support the CAISO's reliance on a PJM-style LMPM proposal, as opposed to a conduct/impact approach, as was implemented in the NY ISO control area. FERC approved the CAISO's proposed PJM-style approach on July 1, 2005.⁴ The CAISO's proposed LMPM mechanism was described in great detail in the CAISO's Conceptual Proposal⁵ that was ruled on in the July 1 Order. In the July 1 Order, the Commission explained how it had outlined the CAISO's market design options in a January 18, 2005 Guidance Letter to the CAISO, providing samples of other market power mitigation schemes that FERC had approved. The July 1 Order concluded that: "Because the CAISO has mirrored PJM's approved market design package, the Commission approves the CAISO's concepts for local market power mitigation measures."⁶ The instant Tariff filing simply provides the tariff language to implement the conceptual LMPM proposal that FERC approved in the July 1 Order. Thus, approval should be *pro forma*.

³ MRTU Tariff Filing Transmittal Letter ("Transmittal Letter") at 33.

⁴ 112 FERC ¶61,013 (2005) ("July 1 Order").

⁵ *California Independent System Operator Corp.*, Docket No. ER02-1656, *et al.*, "Further Amendments to the California Independent System Operator Corporation's Amended Comprehensive Market Design Proposal," filed May 13, 2005 ("Conceptual Proposal").

⁶ July 1 Order at ¶ 122.

3. The CPUC Opposes a Conduct/Impact Approach to LMPM

The CPUC was surprised to learn from the MRTU Tariff Filing that, while the CAISO has taken meaningful steps to implement the PJM-style LMPM proposal approved in the July 1 Order, it is also developing and testing a software application which could support implementation of a NY ISO-style conduct/impact test as an alternative to the PJM-style LMPM upon MRTU implementation.⁷ Significantly, the CPUC has worked with the CAISO throughout the stakeholder process to develop MRTU, and specifically LMPM, and has vocally supported the PJM-style LMPM mechanism before both the CAISO and FERC, with no knowledge that the CAISO was expending resources to pursue this alternative approach to market power mitigation.

As FERC is aware, the conduct/impact approach was never proposed to, or approved by FERC in the MRTU context. In developing this alternative functionality for day 1 implementation, the appearance is that the CAISO has done an end-run around meaningful stakeholder and FERC procedures. The CPUC opposes any further efforts to develop a conduct/impact approach for MRTU implementation. As noted above, this approach was not proposed to or adopted by FERC, and the consequences of implementing this approach have not been meaningfully addressed in any CAISO stakeholder processes.

The CAISO's pursuit of the conduct/impact approach in its software, given its limited resources, and public commitment to the PJM-style approach, is bewildering. As the MRTU Tariff Filing states: "The CAISO has eliminated from the current proposal the alternative NYISO-like conduct and impact approach for local market power

⁷ MRTU Tariff Filing, Attachment M, Exhibit No. ISO-8 (Brian Rahman Testimony) at 6.

mitigation.⁸ The CAISO rejected the conduct/impact approach because it was concerned that such an approach permits an acceptable level of market power because units will bid just below the threshold to avoid being mitigated. The CAISO's Market Surveillance Committee ("MSC") shared these concerns:

Based on California's experience with the AMP mechanism, we do not recommend AMP style approaches to local market power mitigation unless the conduct thresholds are reduced to within 10% of the unit's filed marginal cost, the impact thresholds are substantially reduced or eliminated, and an additional mechanism is used to determine whether a unit possesses local market power so that the tighter LMPM conduct and impact thresholds are applied to a unit's bids.⁹

The MSC concluded: "The PJM approach comes much closer to satisfying the properties of our preferred mechanism."¹⁰

In summary, and as articulated above, the CPUC's support for LMP (and thus MRTU) is contingent upon meaningful LMPM. Like the MSC, the CPUC has concerns with the conduct/impact approach, and believes that the PJM-style LMPM proposed in the MRTU Tariff Filing, and approved in FERC's July 1 Order, is the appropriate model. The CPUC is not convinced that a conduct/impact approach would adequately resolve its concerns, and would insist on a meaningful vetting of the policy issues raised by such an approach before it would be comfortable. Such a vetting has not occurred.

Consequently, it is inappropriate at this stage to seriously consider a conduct/impact approach as a viable MRTU implementation option. This Commission should not

⁸ MRTU Tariff Filing, Attachment K at 24.

⁹ Opinion on the Necessity of Effective Local Market Power Mitigation for a Workably Competitive Wholesale Market, by Frank A. Wolak, Chairman; Brad Barber, Member; James Bushnell, Member; Benjamin Hobbs, Member, Market Surveillance Committee of the California ISO, May 29, 2003 at Section 5, p. 9, *available at* <http://www.caiso.com/docs/2003/07/22/2003072211572411129.pdf>

¹⁰ *Id.* at 10.

consider it as an alternative, and the CAISO should cease expending scarce resources on such an option for day 1 implementation.

4. The CPUC's RA Program Is on Track and Will Complement MRTU's LMPM Mechanisms

The CAISO's May 2005 Conceptual Proposal¹¹ described a number of interrelationships between MRTU and the CPUC's Resource Adequacy program ("RA Program"), and how these interrelationships would complement each other, and supported the adoption of the proposed PJM-style LMPM. The July 1 Order noted these interrelationships, and specifically the CAISO's reliance on: (1) a year-round RA obligation for load serving entities to procure capacity to meet 115-117% of their forecasted load; (2) deliverability requirements for RA resources; and (3) an RA-based must-offer obligation on RA resources.¹² In approving the MRTU's market power mitigation proposal (including LMPM), the July 1 Order noted that:

Our determinations on the CAISO's market power mitigation proposal, as discussed below, are premised upon the plan for resource adequacy that the CPUC is currently considering. To the extent the CPUC's final decision on resource adequacy is markedly different from its proposed plan, we may revisit these determinations.¹³

Since the July 1 Order, the CPUC has made significant progress in advancing the RA principles outlined in the Conceptual Proposal. In October, 2005, the CPUC adopted its third major decision on resource adequacy ("October RA Order").¹⁴ Among other

¹¹ See *supra*, note 5.

¹² July 1 Order at ¶¶ 87-90.

¹³ July 1 Order at ¶ 91.

¹⁴ CPUC Opinion on Resource Adequacy Requirements, D.05-10-042, p. 2 of version mailed October 31, 2005 (all pinpoint citations are to mailed version), 2005 Cal. PUC LEXIS 550, 244

things, that order affirmed the LSE obligation to meet a 15-17% planning reserve margin, and required demonstrations to be made to the CPUC and the CAISO in early 2006 for a June 1, 2006 implementation date.¹⁵ The October RA Order also further addressed deliverability of RA resources,¹⁶ established “counting” rules for RA resources, based on part on their deliverability,¹⁷ and adopted an RA-based MOO that all LSE contracts must contain to count for RA demonstration purposes.¹⁸ Finally, the October RA Order committed to open a new RA proceeding to quickly address the need for a local RA requirement.¹⁹

In December 2005 the CPUC issued an order opening the new RA proceeding, R.05-12-013, to address, among other things, and most significantly, a local RA requirement to be imposed for the 2007 procurement year.²⁰ The order set an ambitious goal of adopting a local RA requirement by June 2006 so that LSEs would be able to procure for a January 2007 implementation date.²¹ Thus far, the proceeding remains on track and the CPUC anticipates that it will meet its goal of having a local RA requirement

P.U.R.4th 341, and available at http://www.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/50731.htm (“October RA Order”).

¹⁵ October RA Order, Section 7.10, pp. 76-82.

¹⁶ October RA Order, Section 7.3, p. 54.

¹⁷ October RA Order, Section 7.3, pp. 43-75.

¹⁸ October RA Order, Section 4.3, p. 21.

¹⁹ October RA Order, Section 9, pp. 96-97.

²⁰ Order Instituting Rulemaking to Consider Refinements to and Further Development of the Commission’s Resource Adequacy Requirements Program, R.05-12-013, issued December 15, 2005, available at http://www.cpuc.ca.gov/PUBLISHED/FINAL_DECISION/52265.htm.

²¹ *Id.* at 5.

in place for 2007. This requirement will ensure that the CAISO has access to local RA resources that it needs in the identified load pockets, thus advancing the CPUC and CAISO goal of ensuring the deliverability of RA resources. After addressing Local RA requirements, R.05-12-013 will then turn to the issue of capacity markets in the second half of 2006.²² Additionally, the CPUC is advancing its RA goals in other, related, proceedings. In February of this year the CPUC opened a proceeding into long term procurement – R.06-02-013.²³ One purpose of this proceeding is to integrate all of the CPUC's procurement policies and programs in one place. The CPUC anticipates that this proceeding will result in the adoption of long term procurement plans by the investor-owned utilities (“IOUs”), covering the period 2007 to 2016, and that it will also address generation investment issues.²⁴

In summary, the CPUC remains committed to the principles upon which the CAISO and FERC relied in implementing the PJM-style LMPM, and has been actively pursuing their development and implementation. Thus, FERC should acknowledge the interrelationship between the CPUC's RA and MRTU and approve the MRTU Tariff's LMPM provisions.

²² See Assigned Commissioner's Ruling and Scoping Memo in R.05-12-013 at 4, issued March 1, 2006, available at <http://www.cpuc.ca.gov/PUBLISHED/RULINGS/54059.htm>

²³ See Order Instituting Rulemaking, R.06-02-013, issued on February 23, 2006, 2006 Cal. PUC LEXIS 43 (Cal. PUC 2006) available at http://www.cpuc.ca.gov/WORD_PDF/FINAL_DECISION/53877.PDF

²⁴ *Id.* at 7-8.

5. The Need for the FMU Bidder Adder Should Be Re-Evaluated Closer To MRTU Implementation

The CAISO proposes to provide a bid adder of \$24 to units that are mitigated 80% of their run hours. These are known as frequently mitigated units or “FMUs.” The July 1 Order conceptually approved the payment of a bid adder to FMUs,²⁵ and the MRTU Tariff implements the details of that mechanism. The CAISO also explains that it is exploring backstop procurement mechanisms to ensure revenue adequacy for FMUs, and that “these alternative mechanisms could replace the bid adder when implemented.”²⁶

The CPUC has previously opposed the FMU bid adder because of concerns that it could undermine the CPUC’s resource adequacy program by sending inaccurate capacity price signals. The CPUC has instead proposed the development of a backstop local capacity contract, which the CAISO committed to developing subsequent to the filing of its MRTU tariff.²⁷

The CPUC once again requests FERC to reconsider the appropriateness of the FMU bid adder in light of the CPUC’s RA program and the other provisions of MRTU, and to instead require the CAISO to develop an appropriate backstop procurement mechanism to replace the bid adder prior to MRTU implementation.

Even the CAISO had reservations about including the bid adder in its May 2005 Conceptual Proposal. It appears that the only reason it was included was to have the MRTU LMPM proposal mirror PJM to ensure FERC approval. In sum, there was no

²⁵ July 1 Order at ¶ 144.

²⁶ MRTU Tariff Filing, Attachment M, Exhibit No. ISO-6 (Keith Casey Testimony) at 6.

principled support for the bid adder. The CAISO's reservations in proposing the bid adder included concerns that: (1) a bid adder would permit FMUs to bid significantly above their marginal costs (*e.g.* cost plus the adder), thus distorting spot market performance; and (2) a "fixed cost" bid adder would not take cost variations, such as variable fuel costs, into account.²⁸ The CAISO's Market Surveillance Committee ("MSC") shared these same concerns.²⁹ Thus, similar to the MRTU Filing now, the Conceptual Proposal noted that the CAISO would be exploring alternatives to the bid adder, in the form of a backstop procurement mechanism.³⁰

The MSC's position on the bid adder has not changed. It has identified the FMU bid adder to be a shortcoming of the CAISO LMPM proposal and has suggested that the costs of the FMU bid adder will outstrip its benefits.³¹ The MSC has remarked that the FMU bid adder "has the potential to introduce substantial costs on both California consumers and generation unit owners facing significant competition for their output, with no counter-balancing market-efficiency benefit."³² On several occasions the MSC has recommended that the market inefficiencies that would be caused by the bid adder

²⁷ *See, e.g.* July 1 Order at ¶ 139

²⁸ Conceptual Proposal at 47.

²⁹ Conceptual Proposal at note 35, and Attachment F at 7-9.

³⁰ Conceptual Proposal at 48.

³¹ Opinion on Aspects of the California ISO's Market Redesign and Technology Upgrade (MRTU) Conceptual Filing, by Frank A. Wolak, Chairman, Brad Barber, Member, James Bushnell, Member, Benjamin Hobbs, Member, Market Surveillance Committee of the California ISO, September 30, 2005, with cover memo dated October 12, 2005, at 1-2 *available at* <http://www.caiso.com/docs/2005/09/30/2005093014203921299.pdf>

³² *Id.* at 1.

justify FERC's deviation from its prior precedent approving of them.³³ In conclusion, the MSC has expressed strong support for generator revenue adequacy, but against providing it at the cost of substantial market inefficiencies.³⁴

The CPUC continues to share these same concerns. Consequently, the CPUC is opposed to the bid adder and respectfully requests the Commission to reject this aspect of the LMPM proposal in favor of the CAISO simply going forward with development of a back-stop procurement mechanism to be available prior to MRTU implementation. This approach is justified because California has features that distinguish it from PJM.

First, the CPUC has taken a "belt and suspenders" approach to revenue adequacy in its RA program, which includes *both* PJM-style deliverability requirements *and* local procurement obligations, which are still evolving in PJM. Consequently, while the FMU backstop may be needed in PJM, where the only assurance of revenue adequacy is currently the deliverability requirements, the CPUC does not believe it is necessary under the CAISO's MRTU. Second, to the extent a backstop may be needed to assure revenue adequacy, development of a CAISO backstop mechanism is more consistent with the MRTU framework, including the CPUC's RA program.

As outlined above, the CPUC's RA program is moving forward; a large part of the program will be in place prior to MRTU implementation, including local procurement obligations. As discussed in Section II.E below, a CAISO backstop procurement mechanism is necessary to implement other significant aspects of MRTU. Given these two factors, combined with the CAISO's renewed commitment to explore backstop

³³ *See, e.g., id.*

³⁴ *Id.* at 1-4.

procurement mechanisms, the CPUC recommends that FERC order the CAISO to develop a backstop procurement mechanism consistent with the discussion in Section II.E below, and report back to FERC regarding whether this mechanism should replace the bid adder prior to MRTU implementation.

C. The CPUC Supports MRTU's Settlement of Demand Charges Based on Three Laps

One of the basic conditions underlying the CPUC's support for MRTU and the move to LMP has been that load would pay weighted average prices for supply based upon a three "zone" (or "LAP") system that corresponds to the three large IOU service territories. Throughout MRTU development, the CPUC has been concerned that, if implemented differently, LMP would result in an unreasonable disparity in retail prices among consumers. As the CAISO correctly notes:

The California transmission grid was not built with the expectation that the system would be used to support an LMP-based market. Further disaggregation of the LAPs for the initial release of MRTU could result in extremely high prices to consumers in congested areas resulting from constraints in a transmission system that was designed and constructed under an entirely different regulatory regime – a regime that did not anticipate competitive Generation markets and nodal pricing.³⁵

Additionally, permitting opt-out or any other form of LAP disaggregation creates perverse customer incentives that will result in a spiraling exodus of customers located at lower-priced nodes from the LAPs, leaving only the highest priced nodes within the LAP.

³⁵ Transmittal Letter at 20-21.

Consequently, while there are theoretical economic benefits from nodal demand pricing, the grid will not soon be in a position to accrue a net gain from any such benefits.³⁶

Significantly, notwithstanding its early approval of the three LAP approach,³⁷ FERC has vacillated on its positions regarding the number and size of the proposed LAP zones, and whether there should be “opt-out” or “special case nodal pricing” (“SCNP”) for specific wholesale customers.³⁸ As to the size of the LAP zones, FERC expressed the concern that large LAPs might impede market participants’ ability to hedge congestion costs due to the lower availability of Congestion Revenue Rights, which results from larger zones.³⁹ However, FERC’s September 19, 2005 “Order on Rehearing” deferred the issue of LAP disaggregation to a CAISO stakeholder process that would consider the results of the CRR Study 2. The CAISO would then propose any necessary changes in its MRTU tariff filing.⁴⁰ FERC’s concerns regarding wholesale opt-out and SCNP were resolved by its November 14, 2005 “Order on Rehearing and Technical Conference” wherein FERC rescinded its order that the CAISO consider these options for day 1 MRTU implementation.⁴¹

³⁶ Notably, the CAISO leaves open the option of revisiting the question of disaggregating the number/size of LAP zones in the future. Transmittal Letter at 20, fn. 22. The CPUC believes that disaggregation of the LAPs may be appropriate after we have had more experience with MRTU.

³⁷ On October 28, 2003, in its “Further Order On The California Comprehensive Market Redesign Proposal,” 105 FERC ¶ 61,140 (the “October 28th Order”), FERC approved the CAISO’s proposal for establishing three load aggregation zones with no allowance for opt-outs. October 28th Order at ¶¶ 34, 65

³⁸ July 1 Order at ¶ 37; and 113 FERC ¶ 61,151 (November 14, 2005).

³⁹ July 1 Order at ¶ 37.

⁴⁰ 112 FERC ¶ 61, 310 (September 19, 2005) at ¶¶ 19-20.

⁴¹ 113 FERC ¶ 61,151 (November 14, 2005) at ¶¶ 12 and 21.

As reflected in the MRTU Tariff Filing, the CAISO has affirmed, after reviewing the result of CRR Study 2 with stakeholders, that the three LAP design is appropriate for California,⁴² and the CPUC supports this determination. The testimony of Scott Harvey and Susan Pope support the CAISO's conclusion that the default LAP structure will not significantly impede LSEs' ability to hedge against congestion costs.⁴³ Consequently, the MRTU Tariff's demand settlement provisions should be approved in full.

D. The CPUC Supports the General CRR Framework, But Supports Modification of the CRR Allocation Mechanism

MRTU will replace traditional firm transmission rights ("FTRs") with congestion revenue rights ("CRRs"), a financial product. MRTU proposes to allocate CRRs first to LSEs, and then auction remaining CRRs to any market participant. As is appropriate in an LMP market, the CRR product will be from "source to sink."

Another cornerstone of the CPUC's support for MRTU is that CRRs be allocated to internal load prior to commencement of MRTU and LMP so that LSEs can adequately hedge themselves against congestion charges in an LMP regime. The CPUC recognizes that a CRR allocation program cannot result in an exact one-to-one hedge; however, the goal is that load is adequately hedged through an allocation of sufficient CRRs. The CPUC understands MRTU to require that internal load receive sufficient CRRs to protect both existing and anticipated future load. The CPUC appreciates the CAISO's efforts to assess whether load will be properly protected and understands that the CAISO has committed to perform CRR Study 3 during the last half of 2006 to allow LSEs to nominate and experience a full illustrative allocation based on the CRR allocation

⁴² Transmittal Letter at 20-22.

methodology approved by FERC. This will, in essence, be a “test drive” for LSEs just prior to the actual allocation and will provide an opportunity for parties to further assess whether LSEs are properly hedged.⁴⁴

1. PNP Nominations Of Up to 66% Should Be Permitted In the First Annual Allocation after Year One

The CPUC strongly supports the CAISO’s overall framework for allocating CRRs to LSEs prior to an auction. However, the CPUC is concerned by a last minute change to the CRR allocation process that was captured in the MRTU Tariff.⁴⁵ Section 36.8.3.5.a of the MRTU Tariff permits LSEs to make PNP (Priority Nomination Process) nominations of up to 33% of their Seasonal CRR Eligible Quantity for each season in the first annual allocation after year one. In the following year, LSEs may nominate, and the CAISO will allocate to the LSEs, Seasonal CRRs of up to 66% of their Seasonal CRR Eligible Quantity for each season on a year-to-year nomination basis. The CPUC recommends that the 66% provision start in the first Annual CRR Allocation after CRR year one, and continued thereafter. Without this change, the CPUC is concerned that LSEs will be unable to meet the CPUC’s policy goal of realizing an adequate hedge against congestion charges in an LMP regime. Furthermore, a policy which will allow up

⁴³ MRTU Tariff Filing, Attachment G at p. 69.

⁴⁴ Transmittal Letter at 26.

⁴⁵ See “Allocation of CRRs to LSEs Serving Load within the CAISO Control Area, Addendum to 9/27/05 Proposal” at <http://www.caiso.com/docs/2005/10/07/200510071142175750.pdf> wherein the CAISO adopted a new allocation proposal limiting grandfathering of existing CRRs, modifying its September 27, 2005 proposal as a complicated compromise reached at the end of the last stakeholder meeting on this issue.

to 66% priority in the initial year allocation after year one would better meet the policy goals identified in the recent FERC NOPR on Long Term Transmission Rights.⁴⁶

2. The CAISO Should Report To FERC Regarding the Results of CRR Study 3

As mentioned above, the CPUC appreciates that the CAISO will be conducting a CRR Study 3. Given the CPUC's goal of ensuring that LSEs obtain an adequate hedge against congestion costs before LMP implementation, the CPUC requests that FERC direct the CAISO to report on how well this goal is met in CRR Study 3 prior to the actual CRR allocation/auction.

3. CRRs Should Not Be Allocated to External Load

MRTU Tariff § 36.9 provides that loads external to the CAISO control area that have a "legitimate need" for CRRs be eligible for a CRR allocation, provided that they pre-pay their expected Transmission Access Charge (TAC) rates for each allocated CRR. "Legitimate need" would include external load served by a generation resource inside the CAISO control area, but it would not extend to external load served by a wheel-through schedule. As a general rule, the CPUC opposes allocation of *any* CRRs to external load. CRRs are a product of the new market design and are a market asset. CRRs are a finite resource and the CRR study shows that there are not enough CRRs to fulfill the requests of loads inside the CAISO control area.⁴⁷

⁴⁶ *Long-Term Firm Transmission Rights in Organized Electricity Markets*, FERC Docket No. RM06-8-000.

⁴⁷ Please see, CRR Study 2 Report, Hogan and Harvey, August 24, 2005. Table 49 shows that the ISO prorated CRR requests to internal load. Column 3 in Table 49 shows that LSE's pro rations on a dollar and MW basis and that LSE requests that were pro rated by the amount in the range of 43.90%-98.48%, P 94 at <http://www.caiso.com/docs/2005/08/24/2005082417481216533.pdf>.

Given that there are not enough CRRs to meet the needs of internal load, the CPUC opposes the CAISO's proposal that external load be eligible for an allocation. Entities outside of the CAISO are served by another control area and have other options. They will also have the option to purchase CRRs through the CAISO's auction process. However, if FERC accepts this CAISO proposal, the CPUC recommends that FERC adopt the CAISO's limited proposal, which mandates pre-payment of TAC charges.

E. The CPUC Protests The CAISO's Overbroad Procurement Authority and Encroachment Into Resource Adequacy – CAISO Procurement Authority Should be Limited and Well Defined

The MRTU Tariff Filing appropriately takes many steps towards facilitating the interrelationship between MRTU and the CPUC's RA program. As both the CPUC and the CAISO have recognized on many occasions, the two programs go hand in hand and the CPUC and CAISO must coordinate to achieve success. The CPUC appreciates that the CAISO's duty to assure the reliability of the transmission grid will, to some extent, overlap with the CPUC's responsibility to provide for the procurement of an appropriate level of reliability at a reasonable cost to ratepayers. However, the MRTU Tariff provisions regarding local resource adequacy requirements and CAISO backstop procurement (Sections 40.3 and 42) fail to strike an appropriate balance between those duties that are properly within the CAISO's jurisdiction and expertise and those areas within the jurisdiction and expertise of the CPUC.

The CPUC and the CAISO are currently engaged in ongoing discussions seeking to reach agreement on revised tariff language or implementation criteria to clarify and appropriately limit the scope of the CAISO's duties and powers to engage in backstop procurement. The CPUC hopes to reach resolution of these issues with the CAISO in

sufficient time to facilitate revisions to the MRTU Tariff prior to FERC's approval of the Tariff. However, to the extent that the CPUC and CAISO are unable to reach agreement on these issues in sufficient time to facilitate an amendment to the proposed tariff, the CPUC proposes that FERC reject both §§ 40 and 42 and that FERC order the CAISO to engage in a stakeholder process to develop alternative MRTU tariff provisions to address CAISO backstop procurement authority under MRTU.

The CPUC is not asking for anything novel. Both FERC and the CAISO properly recognize that states have primary authority over energy procurement planning and long-term electric reliability. The CAISO's Board of Governors "directed CAISO management to defer to State efforts to address the broader issue of Resource Adequacy."⁴⁸ The MRTU Tariff Filing states: "The CAISO has acknowledged that a resource or capacity obligation (*i.e.* the rules and activities for resource procurement) are matters best addressed at the state or local level." Transmittal Letter at 59. This accords with FERC's policy position that states, and not the Regional Transmission Organizations/Independent System Operators (RTO/ISOs), are primarily responsible for long-term procurement of sufficient energy to fulfill regional energy needs:

The approach to and level of resource adequacy will be decided by the states in the region States may decide to ensure resource adequacy through state imposed requirements on utilities serving load within the region. Other states may choose to have RTOs or ISOs operate capacity markets. In any case, the choice on the approach is made by the states within the region."⁴⁹

⁴⁸ *California Independent System Operator Corp.*, FERC Docket No. ER06-723, Interim Reliability Requirements Program filing, March 13, 2006, p. 3 ("Pre-MRTU Tariff Transmittal Letter").

⁴⁹ *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, FERC Docket No. RM01-12-000, "White Paper - Wholesale Power Market Platform," (April 28, 2003) at 12 ("SMD White Paper").

This FERC policy was affirmed in Title XII of the Energy Policy Act of 2005 (“EPAct”), which facilitates the creation of electricity reliability organizations (“EROs”) to promote the reliability of the bulk power system, but expressly retains state authority to assure the reliability of the energy supply within their jurisdictions.⁵⁰ FERC Chairman Kelliher recently reaffirmed this FERC commitment to traditional state authority over energy procurement, and specifically noted California’s active role in this regard:

As a matter of legal authority, the Federal Power Act provides the [FERC] authority to regulate *sales* of electric power at wholesale. . . . [T]he purchase of electricity on behalf of retail customers is an area that has traditionally been regulated by the states. California, which has a state authorized power procurement program in place, is a prime example. I respect the states’ traditional authority in this area.”⁵¹

Finally, as noted by Chairman Kelliher, the California legislature has enacted legislation which, in an exercise of this authority, establishes the framework for California to become resource adequate.⁵²

Pursuant to its authority over energy procurement, the CPUC has taken an active role in balancing California’s energy reliability needs against the costs of infrastructure investments, and has made clear that there will not be reliability at any cost.⁵³ In striking the balance between costs and reliability, the CPUC exercises its obligation to ensure that ratepayers receive reliable, adequate retail service at reasonable rates. Consistent with

⁵⁰ Aug. 8, 2005, P.L. 109-58, Title XII, Subtitle A, § 1211(a), 119 Stat. 941 [Energy Policy Act of 2005] *codified at* 16 U.S.C.S § 824o(i).

⁵¹ Chairman Joseph T. Kelliher, Letter to Hon. Henry A. Waxman, at 1-2 (March 29, 2006).

⁵² California Public Utilities Code § 380 (2006).

⁵³ October RA Order at 8.

the CPUC's exercise of this authority, FERC has recognized that states are empowered to determine the appropriate roles of energy efficiency, demand response, and new generation technologies in assuring future resource adequacy.⁵⁴ While system operators play a key role in assessing the effects of existing and planned facilities on loop flows and system reliability, the responsibility for determining what level of reliability and economic enhancements are appropriate for the state lies primarily on the state's shoulders.⁵⁵ In the case of California, the CPUC has pursued making such decisions on behalf of ratepayers, and the CAISO has been actively involved in most of these determinations.

As discussed in Section II.B.4 above, the CPUC has made great progress in implementing its RA program. RA resources will be made available to the CAISO beginning June 1, 2006 – in less than 2 months. The CPUC has been working with the CAISO and stakeholders since January of this year to create a local capacity requirement to ensure a reliable revenue stream to existing resources, and to incent the construction of new resources in areas where they are most needed. These local area resources should be available to the CAISO beginning January 1, 2007.⁵⁶

Cooperation and coordination between the CPUC and CAISO on RA issues is critical. The CAISO plays an important technical and advisory role in the CPUC's RA

⁵⁴ SMD White Paper at Appendix A, p. 15 (RTO/ISO assessments for the need of transmission enhancements to accommodate non-traditional resource options must be consistent with state directions on policy toward such non-traditional resources.).

⁵⁵ SMD White Paper at Appendix A, p. 16.

⁵⁶ October RA Order at 78.

program.⁵⁷ Among other things, the CAISO establishes transmission inertia allocations for LSEs who import power into the CAISO control area, and publishes a registry of annual and monthly qualified capacity for generation resources. LSEs submit their “year-ahead” filings to both the CPUC and the CAISO,⁵⁸ demonstrating that they have acquired 90% of the capacity sufficient to serve their forecasted retail customer load for the summer months, plus a 15-17% reserve margin.⁵⁹ LSEs will soon begin submitting their month-ahead filings to the CPUC and the CAISO, demonstrating 100% compliance with these requirements. The CPUC and the CAISO will coordinate their review of these filings to ensure LSEs are in compliance with RA program, and the CPUC will take whatever actions are necessary against non-compliant LSEs.

Some aspects of the CPUC’s RA program overlap considerably with issues within the CAISO’s jurisdiction. In some instances, the CPUC and CAISO have been able to work cooperatively to reach a resolution that works for both entities. For example, as articulated in prior FERC filings, the CAISO anticipated that the MRTU Tariff would implement a CPUC-ordered RA-based must-offer obligation (“RA-MOO”).⁶⁰ The CAISO viewed the RA-MOO as necessary for two reasons: (1) as a means to standardize the availability rules applicable to RA resources; and (2) to place the enforcement of those rules with the CAISO as the entity that is most affected by and will most closely

⁵⁷ See, e.g., Cal. Pub. Util. Code § 380(a) (the CPUC “shall establish resource adequacy requirements” “in consultation” with the CAISO).

⁵⁸ Such filings are also made to the California Energy Commission (“CEC”), which also plays a critical role in implementation of the RAR program.

⁵⁹ October RA Order at 2.

⁶⁰ See July 1 Order at ¶ 88, referring to the May 2005 Conceptual Proposal, Attachment B, p. 11.

observe day-to-day compliance with the RA-MOO.⁶¹ In response to these CAISO concerns, the CPUC's October RA Order required LSEs to include an RA-MOO obligation in their contracts with generators. This was clearly within the CPUC's jurisdiction to require from LSEs as a condition of a contract counting towards its RA program. However, the RA-MOO would be ineffectual if the CAISO could not implement the specifics of such an obligation in its MRTU Tariff. The CAISO properly recognized that it needed to exercise its jurisdiction over generators to standardize the rules, monitor their compliance, and take appropriate enforcement actions. In summary, the CPUC properly exercised its authority over LSEs, and the CAISO properly exercised its authority over generators to allow both pieces of the RA MOO puzzle to come together. This type of coordination between the CPUC and the CAISO is critical to the successful implementation of a fully functioning RA program.

Unfortunately, the MRTU Tariff provisions regarding local resource adequacy requirements and CAISO backstop procurement (§§ 40 and 42) fail to strike the appropriate balance between CPUC and CAISO duties. As expressed above, the CPUC understands and agrees that the CAISO has primary authority to ensure the reliability of the transmission system under its control. FERC has observed that an ISO has "authority for maintaining the short-term reliability of the grid that it operates."⁶² In meeting this reliability standard, the CAISO may necessarily need to engage in energy procurement. However, such CAISO procurement authority should be both well-defined and limited to

⁶¹ *Id.*

⁶² SMD White Paper at Appendix A, p. 3.

avoid unnecessary conflict with state procurement authority. The MRTU Tariff misses the mark in this regard.

1. Section 40 Is Confusing and Incomplete and Should Be Re-Worked

The CPUC notes that a number of parties believe that the entirety of § 40 is poorly drafted and results in confusion regarding who will set and who will enforce RA obligations on LSEs. These concerns were expressed with regard to the CAISO's pre-MRTU tariff filing,⁶³ and the CPUC anticipates that they will be raised with regard to the MRTU Tariff Filing. The CPUC agrees that §40 requires additional work. It contains many confusing provisions, lacks certain critical provisions, and reaches the wrong result in others. For example, it is impossible to determine what a "Reserve Sharing LSE" or "Modified Reserve Sharing LSE" is.⁶⁴ Further, while the CPUC supports the CAISO's imposition of the RA MOO on generators (§ 40.6) as a proper exercise of its authority, it

⁶³ Many parties to the proceeding regarding the CAISO's pre-MRTU tariff, the Interim Reliability Requirements Program, FERC Docket No. ER06-723, filed comments criticizing, to various extents, the proposed tariff's improper encroachment into resource adequacy. *See* Pacific Gas and Electric Company Motion to Intervene, Comments and Limited Protest at pp. 3-5 ("the [FERC] should expressly provide that nothing in the CAISO Tariff is to be considered to supersede or otherwise interfere with the actions taken by the CPUC or by any LRA to implement Resource Adequacy."); California Municipal Utilities Association Motion to Intervene and Protest at pp. 8-9 (tariff language should "only be included if the CAISO intended to enforce [RA] compliance through its Tariff, thus federalizing [RA]. Since this is not the CAISO's stated intention, and since California has adopted the [RAR], these provisions are unnecessary"); Alliance for Retail Energy Markets Motion to Intervene and Protest at pp. 2-3, 5-9; Southern California Edison Motion to Intervene and Comments at p. 5; Northern California Power Agency Motion to Intervene at pp. 3-5; Constellation Energy Commodities Group, Inc. ("CCG") and Constellation NewEnergy, Inc. ("CNE") (collectively, "Constellation") Motion to Intervene and Comments at pp. 4-6; Joint Motion to Intervene and Protest of Williams Power Company, Inc., NRG Energy, Inc. and Reliant Energy, Inc. at pp. 16-17 (Tariff requirements for both RA and supply plan yearly and monthly filings are needlessly duplicative); Arizona Electric Power Cooperative, Inc., and Southwest Transmission Cooperative, Inc. Protest and Motion to Intervene at pp. 7-9; City and County of San Francisco Motion to Intervene at pp. 3-5 (questioning CAISO's jurisdiction to implement and federalize RAR, which is still in flux, through its tariff).

⁶⁴ *See, e.g.*, MRTU Tariff §40.1 and the circular definitions provided in Appendix A. A Modified Reserve Sharing LSE is: "A Load Serving Entity whose Scheduling Coordinator has informed the CAISO in accordance with Section 40.1 of its election to be a Modified Reserve Sharing LSE."

is not clear that it is appropriately applied to certain energy limited resources. Most significantly, while §40.4 is an attempt to define the rules regarding the qualifying capacity of generators, it lacks meaningful criteria addressing how and when the CAISO might adjust a generator's qualifying capacity. It defers even addressing such criteria until 12 months after MRTU implementation.⁶⁵ Resolution of these issues is of critical importance to implementation of the CPUC's RA program, and is squarely within the CAISO's duty to address. As recognized in the October RA Order:

... how qualifying capacity will be measured, specific generator performance obligations, and appropriate penalties for generator non-compliance with those obligations, are within the province of the CAISO. It is our understanding that these issues will be addressed in the CAISO tariff and/or protocols implementing its new market redesign. ... **We encourage the CAISO to move quickly to adopt performance criteria and sanctions to meet the proposal's goal of a balance of obligations between LSEs and generators,** and to arrange a sharing of information with LSEs so that they can seek appropriate enforcement of their contracts with generators.⁶⁶

The list goes on. What is clear is that § 40 gets some things right,⁶⁷ and (as discussed in more detail below) gets many things wrong, or simply fails to address issues, such as qualifying capacity criteria, that are necessary for the CPUC's RA program to work on a commercial level. Consequently, as discussed in more detail below, it would be appropriate for FERC to reject all of § 40, and order the CAISO to work with stakeholders to develop a tariff section that reflects the State's authority over resource adequacy, and is therefore appropriately limited to those things clearly within the CAISO's jurisdiction, such as implementation of RA MOO provisions and other

⁶⁵ MRTU Tariff §40.4.5.

⁶⁶ October RA Order at 17-18 (emphasis added).

generator performance obligations. Consistent with this, FERC should order the CAISO to complete its work on qualifying capacity criteria prior to MRTU implementation.

2. Sections 40.3 and 42 Grant the CAISO Unlimited Backstop Procurement Authority

Section 40.3 of the MRTU Tariff establishes a process for the CAISO to adopt and impose local capacity requirements on LSEs.⁶⁸ While the MRTU Tariff provides for collaboration with the CPUC and other entities, the CAISO appears to retain the last word on what the requirements will be.⁶⁹ This is clear from the way the MRTU Tariff obligations are structured. To the extent an LSE does not procure local capacity pursuant to its allocation, the CAISO may procure the deficiency, and allocate the costs of that procurement to the deficient LSE.⁷⁰ Additionally, even if all LSEs meet their allocated local capacity obligations, the CAISO retains the authority to engage in additional backstop procurement to meet any additional needs it identifies later.⁷¹ The costs of this procurement will be allocated to LSEs pursuant to other tariff provisions.

Thus, while the CAISO claims that the Tariff does not impose a local RA requirement on LSEs, the Tariff does just that. The CAISO will set a local area requirement pursuant to § 40.3.1 and allocate the obligation among LSEs pursuant to § 40.3.2; while an LSE is not *required* to demonstrate that it has procured to meet the

⁶⁷ The CPUC appreciates the CAISO's attempt to defer to CPUC RA determinations in §§ 40.1, 40.2, and elsewhere in §40.

⁶⁸ MRTU Tariff § 40.3.1.

⁶⁹ MRTU Tariff § 40.3.1.

⁷⁰ MRTU Tariff at § 40.3.4(i).

⁷¹ MRTU Tariff at § 40.3.4(ii).

requirement (§40.3.3), if no demonstration is made, the CAISO will simply procure the resources and bill the deficient LSE pursuant to § 40.3.4. There is no question that these Tariff provisions establish the CAISO as the final arbiter of Resource Adequacy – “If you do not buy what we want, we will buy it for you.” As the Transmittal Letter clarifies:

...[T]o the extent the resource adequacy programs of the CPUC or other Local Regulatory Authorities fail to incorporate the outcome of the study ..., or where a Scheduling Coordinator fails to satisfy its capacity obligation, the CAISO will utilize its procurement authority and allocate the costs of such CAISO procurement to the Scheduling Coordinators that fail to demonstrate procurement of their proportionate share of local capacity.

As the courts have recognized, FERC may not do indirectly what it is prohibited from doing directly,⁷² and approval of § 40.3 (and, discussed below, § 42) would do just that by allowing the CAISO backstop procurement authority which would effect an end-run around the CPUC’s RA program.

Of almost more significant concern are the provisions that the CAISO may rely upon to engage in backstop procurement, currently captured in MRTU Tariff § 42. As an initial matter, while these provisions are part of the existing CAISO tariff, to the best of the CPUC’s knowledge, the CAISO do not notify MRTU stakeholders that these provisions would be incorporated into the MRTU Tariff. All prior indications were that the CAISO intended to develop an MRTU-specific backstop vehicle after submission of

⁷² *Northern States Power Co., et al. v. FERC, et al.*, 176 F. 3d 1090 (8th Cir., 1999) at 1096:

We think it obvious that the indirect effect of Order No. 888, as interpreted by the Commission, is an attempt to regulate curtailment of electrical power to NSP’s native/retail consumers. Despite FERC’s denial as to nonjurisdictional regulation, we find it has transgressed its Congressional authority which limits its jurisdiction to interstate transactions. As such, its attempt to regulate the curtailment of electrical transmission on native/retail consumers is unlawful, as it falls outside of the FPA’s specific grant of authority to FERC.

the MRTU Tariff to FERC.⁷³ Consequently, the inclusion of Section 42 into the last two pages of the extensive MRTU Tariff is perplexing to many stakeholders.

The CAISO justifies inclusion of § 42 as a necessary “tool” to respond to emergencies: “While the CAISO would not expect to have to use its authority under these sections, it is crucial that the CAISO have this emergency ability to ensure reliability criteria are satisfied.”⁷⁴ However, there is nothing in § 42 to suggest that the CAISO could only use it in emergencies. In fact, it appears that the CAISO would rely on § 42 to meet the local capacity needs it will identify pursuant to § 40.3.

Section 42 provides that the CAISO will prepare its own yearly forecast, broken down to a weekly level, of generation capacity and peak demand.⁷⁵ Since RA requirements are based upon California Energy Commission-adjusted forecasts, this provision, in itself, is a significant departure from the State’s RA policy. If the CAISO-prepared forecast shows that “Applicable Reliability Criteria” cannot be met during peak demand periods, “the CAISO shall facilitate the development of market mechanisms to bring the CAISO Controlled Grid during peak periods into compliance with the Applicable Reliability Criteria (or such more stringent criteria as the CAISO may impose).”⁷⁶ “[I]f the CAISO concludes that it may be unable to comply with the Applicable Reliability Criteria, the CAISO shall, acting in accordance with Good Utility Practice, take such steps as it considers to be necessary to ensure compliance, including

⁷³ See, e.g. July 1 Order at ¶ 139; Transmittal Letter at 70.

⁷⁴ Transmittal Letter at 70.

⁷⁵ MRTU Tariff § 42.1.1.

⁷⁶ MRTU Tariff § 42.1.3.

the negotiation of contracts through processes other than competitive solicitations.”⁷⁷

Section 42 expressly permits the CAISO to contract for up to a year, but it can potentially contract for longer periods.⁷⁸

In summary, it appears that the CAISO intends to compare its own yearly forecasts with “Applicable Reliability Criteria (or such more stringent criteria as the CAISO may impose)[,]” and procure resources if the CAISO believes that its forecasted demand exceeds whatever standard it deems necessary to assure the level of reliability it chooses for the grid.⁷⁹ Any costs of such procurement will be paid by LSEs – and ultimately ratepayers. Nevertheless, there are no limits on this procurement authority, and the MRTU Tariff provides no opportunity for the CPUC, or any other entity, to comment upon the CAISO’s criteria for system reliability.

The CPUC agrees that the CAISO has an obligation to maintain the reliability of the grid consistent with Applicable Reliability Criteria, and that it should have backstop procurement authority to meet those needs. However, the CPUC believes that such CAISO procurement authority should be both well-defined and limited to avoid unnecessary conflict with state procurement authority. As set forth above, § 42 misses the mark.

The CPUC had always understood that the CAISO would work with stakeholders, after submission of the MRTU Tariff, to develop an MRTU-specific backstop procurement mechanism. There were many reasons for the CAISO to develop such a

⁷⁷ MRTU Tariff § 42.1.5.

⁷⁸ Compare MRTU Tariff § 42.1.3 (one year contracts permitted) with § 42.1.5 (open-ended procurement authority).

mechanism, including: (1) to backstop RA program deficiencies identified by the CPUC; (2) to mitigate against the exercise of market power in the bi-lateral contracting market; and (3) to replace the FMU bid adder.⁸⁰ However, as described above, the CAISO inserted § 42 into the MRTU Tariff – with no stakeholder input – and now only notes in passing that it “is considering the development of an alternative backstop capacity mechanism, such as some type of capacity service tariff rate or a local capacity market.”⁸¹ Further, the CAISO does not suggest that such a mechanism would replace § 42. Rather, such an “alternative” “if developed ... would be another tool that would allow the CAISO to ensure that reliability requirements are satisfied.”⁸²

The “tool box” of unlimited backstop procurement mechanisms that the CAISO envisions for itself is, quite simply, incompatible with California’s RA structure. The State must be the final arbiter of the amount of procurement necessary to meet the reliability that retail customers will pay for. Sections 40.3 and 42 of the MRTU Tariff undermine the state’s ability to make this determination by granting the CAISO the ability to engage in unlimited procurement, at ratepayer cost, to meet CAISO-determined reliability needs. A balance must be struck.

Consequently, the CPUC requests that FERC reject §§ 40.3 and 42 of the MRTU Tariff, and order the CAISO to initiate a stakeholder process to develop a limited and well-defined backstop procurement mechanism that will not conflict with state

⁷⁹ MRTU Tariff § 42.1.3.

⁸⁰ July 1 Order at ¶139.

⁸¹ Transmittal Letter at 70.

⁸² Transmittal Letter at 70.

procurement authority and RA programs.⁸³ Such a mechanism should only permit short term procurement (less than a year), so as not to undermine longer term contract markets, should be transparent to stakeholders, and should require the CAISO explain, in detail, the reasons for any such procurement. These criteria are critical to prevent CAISO backstop procurement from undermining RA procurement, and will reveal any gaps in RA procurement to be corrected by LSEs, thus limiting the need for CAISO backstop procurement.

F. The CPUC Supports the CAISO’s Participating Intermittent Resources Proposal (“PIRP”)

1. PIRP Provides Needed Financial Certainty to Intermittent Resources

During the MRTU development process, the CAISO sponsored a stakeholder process to develop a proposal to ensure that intermittent resources, such as wind, solar, and small hydro resources, would be appropriately accommodated in MRTU; this effort has become known as “PIRP”. One of the key goals of the CAISO’s PIRP effort has been to design market rules that minimize intermittent resources’ exposure to imbalance energy deviations and uninstructed deviations penalties in the real-time market because intermittent resources, like wind resources, cannot control their output and maintain a predictable schedule.

Beginning in 2004, the CAISO implemented tariff provisions to accommodate intermittent resources. These provisions include exemptions from uninstructed deviation penalties, and alternative treatment for real-time deviations that reduce their financial

⁸³ Such a technical conference or stakeholder process might consider the terms of the offer of settlement filed in the *Independent Energy Producers Association v. CAISO*, Docket No. EL05-

exposure to deviation penalties. These tariff provisions have been carried into the MRTU Tariff.⁸⁴

The CPUC commends the CAISO's development of these key market rules, and incorporation of them into MRTU. The CPUC understands that these tariff provisions should reduce financial risks for PIRP resources and provide a measure of certainty by settling real time deviations over a monthly period.

California's Energy Action Plan II includes a goal that 20 percent of electricity sales come from renewable sources by 2010.⁸⁵ The certainty provided by the CAISO's PIRP program will be meaningful factor in encouraging the further development of intermittent resources, thus enhancing California's ability to meet its aggressive renewables goal.

2. The MRTU Tariff Must Account for PIRP in the RUC Target

During the MRTU stakeholder process, the CPUC and other parties raised the issue of potential over-procurement in the Residual Unit Commitment ("RUC") process, unless the CAISO adjusts the day-ahead schedule or RUC to account for intermittent generation being available in real time. In short, intermittent resources cannot provide reliable day-ahead schedules; shortfalls in day-ahead schedules are covered by RUC procurement; however, intermittent resources may be available in real-time that could

146-000 on March 31, 2006, as a starting point for discussion of appropriate boundaries for CAISO backstop procurement.

⁸⁴ See generally Transmittal Letter at 84-85; MRTU Tariff §§ 11.12 and 34.19.2.5 and Attachment Q - Eligible Intermittent Resources Protocol.

⁸⁵ Energy Action Plans I and II are available at: <http://www.cpuc.ca.gov/static/energy/electric/energy+action+plan/index.htm>

displace such RUC procurement, and the CAISO needs to develop mechanisms to accommodate this.

The CPUC supports the CAISO's efforts to address this issue in the coming months. However, the CPUC suggests that any rules regarding the RUC procurement target be reflected in amendments to the MRTU Tariff.⁸⁶ Less significant issues may be addressed in a Business Practice Manual ("BPM").

3. The CAISO Should Establish a Schedule to Address Additional PIRP Issues in Release 2

Given that California expects to see significant additional development of intermittent resources over the next few years, the CPUC Requests that the CAISO initiate a stakeholder effort to address additional issues related to the integration of intermittent resource issues into MRTU for Release 2. For example, the CAISO should consider investigating forecasting and control room technologies that could improve upon the CAISO's current ability to forecast wind. Improved forecasting technologies and control room technologies will improve the integration of wind into the CAISO market. Such an effort would also be in keeping with the CAISO's commitment to develop a proposal for supporting State policy regarding renewables by the end of 2006 (Board memo Oct 2005).

4. The CAISO Should Establish a Schedule to Address Loss Over-Collection Issues in Release 2

The CPUC understands that the CAISO plans to address the California Energy Commission's proposal regarding the rebate of transmission line loss over-collections for

⁸⁶ See MRTU Tariff § 31.5.3.

renewable resources as a Release 2 item.⁸⁷ The CPUC requests that the CAISO set a schedule soon to address this issue as a priority item in Release 2.

G. The CPUC Opposes Any Last-Minute Attempt to Include Virtual Bidding into Day 1 MRTU

As FERC is well aware, there have been a number of pleadings filed recently in the earlier MRTU docket, ER02-1656, *et al.*, urging the imminent implementation of virtual bidding.⁸⁸ The CPUC agrees with the CAISO's concerns that "virtual bidding cannot be implemented for MRTU Release 1 without a delay in the initial release of MRTU."⁸⁹ Mr. Rahman testifies that "implementation of virtual bids could require an additional 12-months on top of the revised implementation date of November 2007."⁹⁰ Further, as implied in Mr. Rahman's testimony, if included, virtual bidding would introduce yet another complex and untested element into an already complicated market design, introducing additional uncertainty regarding whether MRTU will function properly.⁹¹

The CPUC believes that implementation of virtual bidding should be reserved for a time when all other MRTU features are in place and running without dysfunction.

⁸⁷ Transmittal Letter at 95-96.

⁸⁸ *See, e.g., California Independent System Operator Corp.*, FERC Docket No. ER02-1656, *et al.*, "Answer to California Independent System Operator Corporation's Status Report, and Motion to Supplement Protest and Supplemental Protest of Williams Power Company, Inc.," filed February 7, 2006..

⁸⁹ Transmittal letter at 95; *see also* MRTU Tariff Filing, Attachment M, Exhibit No. ISO-8 (Brian Rahman testimony) at 10.

⁹⁰ MRTU Tariff Filing, Attachment M, Exhibit No. ISO-8 (Brian Rahman testimony) at 10.

⁹¹ MRTU Tariff Filing, Attachment M, Exhibit No. ISO-8 (Brian Rahman testimony) at 10 ("Such a change would modify all downstream data stores as well as the integration of all major

Further, given the significance of the issue, California stakeholders deserve the opportunity to address the policy issues regarding virtual bidding, and participate in the development of any tariff provisions for its implementation. The CPUC recognizes that virtual bidding is already in place in other markets. However, the CPUC notes that virtual bidding was not implemented in PJM and New York until there was assurance that those markets were properly functioning. California deserves the same opportunity.

H. The Import Capacity Allocation Must Be Non-Discriminatory

Section 40.4.6.2 of the MRTU Tariff allocates import capacity among LSEs for RA purposes after the CAISO performs its annual deliverability study. The RA significance is that imports can only count towards the CPUC's RA program to the extent they have dedicated import capacity pursuant to this allocation. The CPUC is concerned that § 40.4.6.2 improperly discriminates against CPUC-LSEs by allocating import capacity first to non-CPUC LSEs, leaving the residual to be allocated among CPUC-LSEs. The CPUC urges that this section be revised such that all import capacity is allocated at the same time and on the same basis.

The CPUC recognizes that due to the press of time to meet the June 1, 2006 RA implementation deadline, the 2006 allocation employed a simple approach which followed the dictates of the MRTU Tariff provision. However, the CPUC understood that this process would be refined and updated. The time has come for that refinement, and the MRTU Tariff should be revised as proposed.

I. Several Critical Items Are Not Addressed In the MRTU Tariff and Should Be the Subject of Technical Conferences

systems. It would require significant testing, market trials, and training to insure proper implementation. Significant training for Market Participants would be required as well.”)

There are several critical features missing from the MRTU Tariff which must be in place prior to MRTU implementation, and which would benefit from discussion in the context of FERC-sponsored technical conferences held in California. These include:

- The development of objective “readiness” criteria that would apply pre-MRTU to ensure that MRTU will not be implemented until there are assurances that it will operate properly;
- Safeguards incorporated into the MRTU Tariff to identify if the MRTU markets are not operating in a competitive manner, and mechanisms to correct for these problems; and
- What things can be properly delegated to a Business Practice Manual and what things must be addressed in the MRTU Tariff, but have not yet been addressed.

The CPUC understands that other parties will be addressing these issues in their comments, and so will not belabor the point here. In short, the CPUC shares these concerns and requests FERC to sponsor technical conferences to address these critical issues.

III. CONCLUSION

As explained above, the CPUC supports the majority of the CAISO’s MRTU Tariff Filing and urges the Commission to act no later than June 2006 on the MRTU Tariff so that MRTU can move forward consistent with the project schedule. However, FERC should not approve the MRTU Tariff without modification, and with an effective date of November 1, 2007, as requested by the CAISO.⁹² Rather, FERC should approve the CAISO’s proposed effective date for the MRTU Tariff, contingent upon a compliance filing that incorporates certain modifications to the MRTU Tariff, based upon a number of follow up activities. The CPUC respectfully requests that the Commission adopt the

⁹² Transmittal Letter at 8.

CPUC's recommended modifications to the MRTU Tariff and/or order appropriate actions to be taken by the CAISO, including, among other things:

- Ordering the CAISO to develop a backstop procurement mechanism consistent with the discussion in Section II.E, and report back to FERC regarding whether this mechanism should replace the FMU bid adder prior to MRTU implementation;
- Ordering that MRTU Tariff § 36.8.3.5.a be modified to permit LSEs to make PNP (Priority Nomination Process) nominations of up to 66% of their Seasonal CRR Eligible Quantity for each season in the first annual allocation after year one, and every year thereafter;
- Ordering the CAISO to report to FERC regarding the results of CRR Study 3 prior to the first actual CRR allocation and auction;
- Ordering that loads external to the CAISO control area not be eligible for a CRR allocation;
- Rejection of MRTU Tariff §§ 40 and 42, with instruction for the CAISO to reconvene with stakeholders to develop tariff provisions consistent with State procurement authority, including development of: (1) a well-defined and limited backstop procurement mechanism; and (2) qualifying capacity criteria;
- Ordering the CAISO to develop MRTU Tariff language to account for PIRP in the RUC target;
- Ordering the CAISO to initiate a stakeholder effort to address additional issues related to the integration of intermittent resource issues into MRTU for Release 2, including, most importantly transmission line loss over-collection issues;
- Revision of § 40.4.6.2 to make the CAISO's import capacity allocation process non-discriminatory; and

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- Sponsoring California-based technical conferences to address the need for objective pre-MRTU readiness criteria and post-MRTU safeguards, and issues currently delegated by the CAISO to the Business Practices Manuals which should be addressed in the MRTU Tariff.

Respectfully submitted,

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Utilities Commission

April 10, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused to be served a copy of the foregoing document upon each person designated on the official service list in this proceeding in accordance with the requirements of Rule 2010 of this Commission's Rules of Practice and Procedure.

Dated at San Francisco, California, this 10th day of April 2006.

/s/ HALINA MARCINOWSKI

HALINA MARCINOWSKI

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