

STATE OF CALIFORNIA

ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
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VIA ELECTRONIC POSTING

May 16, 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*

Dear Ms. Salas:

Enclosed for filing in the above-docketed case, please find an original electronic filing of the attached document entitled, "**REPLY COMMENTS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION ON THE CALIFORNIA ISO'S MRTU TARIFF.**"

Thank you for your cooperation in this matter.

Sincerely,

/s/ Elizabeth D. Dorman

Elizabeth D. Dorman
Staff Counsel

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

California Independent System)
Operator Corporation)
_____)

Docket No. ER06-615-000

**REPLY COMMENTS
OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION
ON THE CALIFORNIA ISO'S MRTU TARIFF**

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**REPLY COMMENTS
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The California Public Utilities Commission (“CPUC”) appreciates the opportunity to provide reply comments to the Federal Energy Regulatory Commission (“FERC” or “Commission”) on the *California Independent System Operator Corporation (“CAISO”) Electric Tariff Filing to Reflect Market Redesign and Technology Upgrade* (“MRTU Tariff”), which was submitted to the Commission on February 9, 2006.

The CPUC’s Reply Comments will address the following points raised in the initial comments of other parties in this proceeding:

- Certain aspects of the MRTU Tariff would unduly interfere with the CPUC’s jurisdiction over resource adequacy;
- Key modeling information must be provided, and the Nodal Price Calculation Method must be transparent; the CAISO must have safeguard measures in the CAISO Tariff;
- The CAISO must provide key implementation elements to assure market participant readiness and should adjust the overall implementation schedule to allow for a smooth transition to the new energy market;
- The MRTU market structure should provide greater reliability for LSEs that provide adequate power supply to satisfy load during times of system stress;
- The CPUC supports an MRTU Readiness Certification Process, and FERC review of that process, prior to the CAISO’s launch of MRTU;
- PJM Style of local market power mitigation should be adopted;

- Ancillary services should be subject to local market power mitigation;
- Congestion Revenue Rights allocation must adequately hedge transmission costs;
- The automatic rise in the Energy Bid Cap is not supported by the record; it improperly binds future Commissions and impermissibly delegates the Commission's exclusive responsibilities;
- The CPUC supports the request for a Technical Conference on the allocation of Marginal Transmission Losses;
- Demand Response issues should be addressed as soon as possible, before Release 2; and
- The CAISO's proposed requirement of 45 days' notice for transmission outages is unreasonable and unwise.

COMMUNICATIONS

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REPLY COMMENTS

I. CERTAIN ASPECTS OF THE MRTU TARIFF WOULD UNDULY INTERFERE WITH THE CPUC'S JURISDICTION OVER RESOURCE ADEQUACY¹

In the Comments that it submitted in this Docket on April 10, 2006 (hereinafter, "CPUC Comments"), the CPUC indicated that some portions of the MRTU tariff threatened to impede the efficacy of the CPUC's Resource Adequacy program.² Several other parties expressed support for this position in their comments on the MRTU tariff.³

Moreover, even the CAISO has recognized the need for it to defer to the "authority of State and local authorities regarding long-term planning reserves (i.e., resource adequacy determinations)"⁴ while it pursues its own proper goal of ensuring short-term grid reliability.⁵

¹ The CPUC notes that FERC filed its *Order Accepting Tariff Revisions, As Modified* in Docket ER06-723-000 on Friday, May 12, 2006, just a few days ago. The CPUC has not yet had the opportunity to digest this nearly 40 page Order, which addresses issues similar to those discussed in this section, and therefore reserves the right to file supplemental reply comments regarding the MRTU Tariff in light of this new, related opinion.

² See, in particular, pages 29 to 34 of the CPUC Comments.

³ See, the Comments of Pacific Gas & Electric Company ("PG&E") filed in this docket on April 10, 2006 (hereinafter, "PG&E's Comments"), at pages 12-13 ("In the name of reliability, CAISO asks the Commission to provide it with authority over a subject matter that the Congress . . . expressly denied to both the Commission and the Electricity Reliability Organization."); also see, the Comments of the Southern California Edison Company ("SCE") filed in this docket on April 10, 2006 (hereinafter, "SCE's Comments"), at pages 11-15 (objecting to several "conflicts with CPUC RA rules"); also see, the Comments of the Cities Of Anaheim, Azusa, Banning, Colton, Pasadena, And Riverside, California filed in this docket on April 10, 2006 (hereinafter, "Six Cities Comments") at pages 15-16 ("the current ISO proposal still falls short of a reasonable balance [between state and ISO/federal jurisdiction] and unnecessarily interposes the ISO in the procurement decisions of the LSEs. Several critical provisions of the proposed MRTU Tariff deviate from the announced standard of deference to LRAs."); also see, the Comments of the California Municipal Utilities Association filed in this docket on April 10, 2006, at pages 20-31 (reiterating concerns raised in FERC Docket No. ER06-723 regarding CAISO intrusion upon state and local RA jurisdiction); also see, the Protest of the City And County Of San Francisco filed in this docket on April 10, 2006 at pages 5-7 (tariff language "federalizes" what is now state and local law); also see, the Comments of the Alliance For Retail Energy Markets filed in this docket on April 10, 2006 at pages 10-11 (CAISO tariff forces LSEs to "serve two masters" on RA rules), etc.

⁴ *Motion For Leave To File Answer Out Of Time And Answer Motions To Intervene, Comments And Protests Of The California Independent System Operator Corporation* ("CAISO IRRP Answer") filed in FERC Docket No. ER06-723 at pp. 4, 21 ("[T]he CAISO agrees that State regulators and the LRAs have primary responsibility for resource adequacy.").

⁵ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities* ("Order No. 888") FERC Docket No. R.95-8-000 at page 282.

“An ISO may also have a role with respect to reliability planning.”⁶ The ISO’s role, however, “should be well-defined and comply with applicable standards set by NERC and the regional reliability council.”⁷

In comments in Docket No. ER06-723 regarding its Interim Reliability Requirements Program (“IRRP”) Tariff (which is intended to be in effect until the MRTU is implemented), the CAISO noted that California’s 1996 restructuring law, Assembly Bill 1890, directed it to seek from the Commission “the *ability* to secure generating and transmission resources necessary to guarantee achievement of planning and reserve criteria no less stringent than those established by the [WECC] and the [NERC].”⁸ Notably, this statute does not require the CAISO to *actually secure* generation resources beyond those required to satisfy NERC/WECC criteria. Decisions about whether and how to exceed NERC/WECC criteria are left to the state.

The CAISO stated that its IRRP tariff section 40.3.1, which requires the CAISO to produce and publish a twelve-month forecast of generation capacity and demand, facilitates its existing obligations to establish and maintain planning and reserve criteria pursuant to NERC/WECC standards.⁹ The CPUC agrees that it is necessary for the CAISO to collect data to determine the generation and transmission that will be needed to calculate the state’s energy needs and an appropriate buffer for reliability purposes. For this reason, the California Energy Commission assists the CPUC’s administration of the Resource Adequacy program by creating a forecast of energy capacity and demand.¹⁰ The CAISO receives such information from CPUC

⁶ *Id.* (ISO Principle No. 4).

⁷ *Id.*

⁸ Chapter 854, Stats. 1996 (“A.B. 1890”), § 1, subd. (c), emphasis added.

⁹ *CAISO IRRP Answer* at page 7.

¹⁰ *CAISO IRRP Answer* at page 41 (“The CAISO recognizes that for the CPUC-jurisdictional entities it has received the initial annual plans.”)

jurisdictional entities through the Resource Adequacy process and contributes substantially to the Resource Adequacy program.¹¹

Indeed, in the Order that the Commission just issued, on May 12, 2006, in Docket No. ER06-723¹² accepting the tariff revisions filed by the CAISO, the Commission has apparently recognized these limitations on the CAISO's authority, as well as the importance of the CAISO's ability to collect relevant data, at ¶ 28:

We are cognizant of the parameters of our authority with respect to resource adequacy. Several provisions of the Federal Power Act (FPA) limit the Commission's authority to require the enlargement of generation or transmission facilities. [footnote omitted] Consistent with this view, we find that the CAISO's proposed IRRP tariff revisions, as modified herein, will not interfere with the resource adequacy decisions of the CPUC or other LRAs. Rather, we find that the IRRP tariff revisions, as modified, will help provide the CAISO with critically needed data to help ensure the reliable operation of the CAISO grid, consistent with the requirements of ISO Principle 4, AB 1890, and WECC/NERC obligations.

A conflict arises, however, if both the CPUC and the CAISO were to determine demand and set semi-parallel reliability requirements. While the CPUC's Resource Adequacy program has been and continues to be developed in an open proceeding subject to substantial stakeholder input, the CAISO's determinations of the grid's needs are shrouded in mystery. The MRTU tariff does not reveal what methods it will use to set its reliability standard. Rather, the CAISO states that it shall procure to meet not only "Applicable Reliability Criteria" but beyond this, whatever "such more stringent criteria as the CAISO may impose[.]"¹³

¹¹ *Id.*

¹² See, 115 FERC ¶ 61,172.

¹³ MRTU Tariff § 42.1.3.

As the CAISO recently stated, “there are limits as to what the CAISO can do to meet its Applicable Reliability Requirements and not impinge on state and local responsibilities for Resource Adequacy.”¹⁴ However, an unlimited ability to engage in backstop procurement such as that described in the MRTU tariff carries the potential to do just that. The CAISO’s proposed backstop procurement mechanism elucidated in section 42 of the proposed MRTU Tariff reflects no consideration of the cost of such procurement. Given that market power remains a significant concern in load pockets all over California, generators could see a perverse incentive to avoid entering into Resource Adequacy contracts with utilities, which will obligate their plants to operate when called upon (and, in this way, to avoid the potential exercise of market power), in favor of waiting for a potentially more lucrative contract with the CAISO. If, in fact, a “primary purpose of the [CAISO’s proposed tariff] is to transition away from the FERC must-offer requirement, to reliance on resources secured by LSEs under the auspices of programs established by (the CPUC, municipalities and other) LRAs[,]”¹⁵ the MRTU tariff is a poorly tailored means of achieving that goal, and the approach taken there may even be counterproductive in this important respect. As stated by PG&E, “The CAISO’s MRTU should carefully mesh with and support CPUC determinations on Resource Adequacy, which are the primary means of assuring the future adequacy of energy supplies for California. Market design elements that overlap with CPUC Resource Adequacy policy should be disfavored and minimized.”¹⁶

Notwithstanding these broadly shared concerns of the CAISO’s stakeholders, the CAISO contends that the creation of specific resource adequacy filing requirements within its IRRP tariff

¹⁴ CAISO IRRP Answer at page 9.

¹⁵ CAISO IRRP Answer at page 10 (regarding the proposed IRRP tariff).

¹⁶ See, PG&E’s Comments at page 12.

language would limit the ability of the CPUC and other Local Regulatory Authorities (“LRAs”) to design their own Resource Adequacy program: “Any additional language in the CAISO Tariff [stating due-dates for IRRP Resource Adequacy filings] could improperly limit the CPUC’s ability to modify the schedule under its resource adequacy program.”¹⁷ Also see, the Commission’s May 12, 2006 Order in Docket ER06-723, addressing this problem in context of the IRRP.

The CPUC is gratified by this apparent deference by the CAISO to the Resource Adequacy programs of the CPUC and other LRAs, but the proposed MRTU Tariff would nonetheless create a mechanism that could unduly and unnecessarily interfere with the resource adequacy-related decisions of the CPUC and LRAs. For example, the CPUC has developed a detailed method for addressing how use-limited resources are to be counted based upon stakeholder input, including input by the CAISO.¹⁸ However, proposed MRTU tariff section 40.6.4.1 would essentially give the CAISO the power to veto whether a resource qualifies as “use-limited,” and subjects this decision to the CAISO’s internal ADR process if there is disagreement regarding this classification. As discussed elsewhere in these comments, the MRTU’s delegation of substantial details of its implementation to Business Practice Manuals or other CAISO-controlled mechanisms threatens to infringe upon the CPUC’s determination of how to integrate renewable and demand response resources into the state’s Resource Adequacy program.

A similar concern exists with regard to the ultimate responsibility for counting the value of the resources necessary to meet California’s Renewal Portfolio Standard (“RPS”)

¹⁷ CAISO IRRP Answer at p. 41.

¹⁸ See, California Public Utilities Commission, *Opinion on Resource Adequacy Requirements*, D.05-10-042, October 27, 2005, at pages 73-75.

requirements. In this regard, the CPUC agrees with the discussion at pages 14-15 of SCE's Comments, in which SCE objects to a proposed Tariff requirement that wind and solar resources must participate in the CAISO's Participating Intermittent Resources Program ("PIRP"). The CAISO's PIRP program provides important benefits to certain providers of renewable resources to California's LSEs, but the PIRP program is, by its nature, a voluntary one. In the view of the CPUC, it is inappropriate for the CAISO to use the promulgation of the MRTU Tariff to modify the parameters of a program that primarily affects a limited segment of the CAISO's stakeholders. If the CAISO thinks that there are some modifications that need to be made to the PIRP program, it would be far better for all parties concerned for the CAISO to convene a separate set of discussions, limited to PIRP-related issues, with that set of stakeholders. Once the parties can reach agreement on appropriate changes to the PIRP program, those changes can be submitted for FERC approval in a separate filing.

In sum, the MRTU as currently drafted tends to confuse the issues of: (1) which agency determines Resource Adequacy counting rules; (2) what types of resources bear what kind of value within the CPUC's Resource Adequacy program; and (3) which agency decides what price consumers should pay for what level of long-term reliability. "Section 215(i)(2) of the Federal Power Act expressly provides that the Act 'does not authorize . . . the Commission . . . to set and enforce compliance with standards for adequacy or safety of electric facilities or services.' 16 U.S.C. § 824o(i)(2) (2006). The Resource Adequacy provisions of the MRTU Tariff must not overstep the boundaries of the ISO's and the Commission's authority in this area."¹⁹

¹⁹ See, Six Cities Comments, at page 15.

II. KEY MODELING INFORMATION MUST BE PROVIDED AND THE NODAL PRICE CALCULATION METHOD MUST BE TRANSPARENT; THE CAISO MUST HAVE SAFEGUARD MEASURES IN THE CAISO TARIFF

A. Modeling Assumptions and Input Information Must Be Transparent and Provided to LSEs

PG&E argued in its Comments that the CAISO methodology for calculating nodal prices should be clearly specified in the CAISO tariff.²⁰ As described in the CPUC Comments, the CPUC is implementing a major procurement and resource adequacy program mandated by state law²¹ and wants the LSEs to have the information and tools necessary to meet their procurement obligations at a reasonable cost. Given the importance of this mandate and the potential impact to the California economy of implementing MRTU, the CPUC stresses that it is critical that the CAISO provide the LSEs with key MRTU modeling information so that LSEs may be best prepared to plan, hedge, and operate in the locational marginal pricing (“LMP”) and MRTU market.

The CAISO provided testimony with its MRTU tariff filing addressing its calculation of LMPs. This discussion, however, is theoretical rather than specific.²² In addition to understanding the theory behind the CAISO’s approach to LMPs, market participants (“MPs”) need to clearly understand the CAISO’s calculation methodology in order to analyze, plan and manage their resource portfolios. For example, knowledge of the grid’s actual transmission constraints would allow LSEs to determine which generators would provide deliverable energy with the least additional transmission expense. Some examples of specific information that LSEs need to engage in such planning include:

²⁰ See, PG&E’s Comments, at pages 43 - 46.

²¹ See, California Public Utilities Commission, *Opinion on Resource Adequacy Requirements*, D.05-10-042, October 27, 2005.

- transmission flow limits/constraints;
- other full network model (“FNM”) assumptions; and
- load modeling assumptions, including the CAISO’s methods for taking highly aggregated schedules and spreading them out to individual load nodes, and other technical information necessary to understand how the load modeling will work.

The CPUC supports PG&E’s call for a technical conference for the purpose of fully explaining the details behind the nodal price calculations.²³ Attached to these Reply Comments are two recent items of correspondence to the CAISO Governing Board from a variety of MPs. These items contain what the CPUC believes to be legitimate suggestions and concerns about what showings should be required before MRTU “goes live” in order to assure successful launch of the new market paradigm.²⁴

The CPUC supports stakeholder requests for CAISO release of the Full Network Model. The CPUC also requires this information itself in order to determine whether the CAISO’s modeling assumptions are consistent with the state’s priorities regarding dispatch of energy.²⁵ The CPUC understands that the CAISO has been considering legal issues regarding the release of such information. In public comment at the last CAISO Board meeting, Dr. Barbara Barkovich, of California Large Energy Consumers Associations (“CLECA”), explained that other ISOs/RTOs have released their FNMs to MPs. The CPUC requests that the CAISO clarify when it will provide MPs with the FNM. Should the CAISO decline to release the FNM to LSEs, the CPUC requests that the FERC issue an Order requiring the CAISO to show cause why

²² See, Direct Testimony of Farrokh Rahimi, filed in support of the CAISO’s MRTU Tariff in this Docket, at page 33 *et seq.*

²³ See, PG&E’s Comments, at pages 45-46.

²⁴ The attached documents are: “Stakeholder letter on MRTU Implementation,” March 3, 2006, and Comments of Pacific Gas and Electric Company on “Input on MRTU Readiness,” March 24, 2006.

²⁵ See, *California’s Energy Action Plan II* at <http://www.cpuc.ca.gov/PUBLISHED/REPORT/51604.htm>.

it should not be obligated to release this information to all LSEs serving load within the CAISO system.

B. The CAISO Tariff Must Include Methods To Modify MRTU Systems In The Event Of Unexpected Post-Implementation Effects.

The CPUC agrees with PG&E's support of the CAISO's plan to propose additional tariff provisions in MRTU that will allow the CAISO to immediately respond to MRTU flaws that may arise. The CPUC agrees that these measures must be in place prior to the implementation of MRTU, and that the CAISO should work with stakeholders to develop this tariff language to provide for such safeguards.

III. THE CAISO MUST PROVIDE KEY IMPLEMENTATION ELEMENTS TO ASSURE MARKET PARTICIPANT READINESS AND SHOULD ADJUST THE OVERALL IMPLEMENTATION SCHEDULE TO ALLOW FOR A SMOOTH TRANSITION TO THE NEW ENERGY MARKET

Most parties' initial comments express a common theme regarding the MRTU implementation schedule:²⁶ The CAISO must provide key elements necessary for MPs preparation for MRTU implementation and must set an adequate schedule to assure MP readiness. The MPs correctly argue that these necessary pieces of information must be available with sufficient advance time to allow the MPs to prepare for MRTU going live. Without these elements in place with sufficient lead time to meet the needs of the MPs, the MPs will not have the necessary opportunity to prepare for the real-time implementation of MRTU, and implementation schedule for MRTU will necessarily be delayed, or, worse, the implementation of MRTU could be beset with serious -- and unnecessary -- start-up difficulties. These elements include:

- Development of Business Practice Manuals ("BPMs")

²⁶ See, e.g., the comments of SCE, PG&E, CLECA, *et al.*, filed in this Docket, and Appendix A, attached to these Reply Comments.

- Specifications for Automated Program Interface Documentation (“APID”)
- FERC Order Approving MRTU

A. Business Practice Manuals

The CAISO’s proposed BPMs will contain critical information on how the CAISO will operate and do business with MPs under MRTU. Nine to twelve months before market simulations under MRTU are scheduled to begin, MPs must develop requests for proposals (“RFPs”) and secure vendors to develop the systems and software necessary for those MPs to participate in the CAISO’s new market.²⁷ However, the MPs will need the BPMs to be in a near-final state before they can prepare those RFPs. Relying on the MPs’ most optimistic estimates of the time they will need to be ready for the market simulations (which alone will require two to three months), the BPMs must be finalized by November of 2006 -- if MPs are to participate meaningfully in the MRTU Market Simulations, and MRTU is to go live by November 1, 2007, the currently scheduled implementation date.

The CAISO has only recently begun the effort to work with stakeholders to develop its BPMs. The CAISO released draft BPMs regarding “Market Operations,” “Market Instruments,” “Settlements & Billing” and “Definitions & Acronyms,” and plans to hold stakeholder meetings on this initial set of BPMs during the last two weeks of May, 2006. The CAISO will be rolling out nine more BPM topic areas and will be working with stakeholders on these forthcoming BPMs during the summer of this year. The CAISO expects to finalize the first four BPMs in October of this year, and it is reasonable to project that the remaining BPMs will not be in essentially final shape until early in 2007.

²⁷ See, various comments filed in this Docket, as well as the CAISO’s presentation on MRTU Stakeholder Readiness - Needs and Approaches at <http://www.aiso.com/17db/17dbbf86b7c0.pdf>

The CPUC believes that this projected schedule for the development and adoption of BPMs allows insufficient time for MPs to prepare the systems and software ready to participate meaningfully in CAISO Market Simulations in the summer of 2007. Consequently, both the CAISO and the Commission need to recognize and acknowledge that it is likely to require more time than is currently envisioned to complete all of the tasks necessary to start up MRTU in the careful, rational and planned manner that is necessary to assure a successful implementation of this complex new market design.

B. Specifications For Automated Program Interface Documentation

The CPUC understands that the CAISO has not issued complete specifications for APID.²⁸ Functionality of this element of MRTU is critical to MP readiness, because this documentation establishes the way in which MPs will communicate with the CAISO software. Again, unless the APID specifications are completed and available for use by the MPs with sufficient advance time (*i.e.*, by the latter part of this year) to enable the MPs to prepare the systems and software necessary to enable them to meaningfully participate in CAISO Market Simulations in the summer of 2007, further delays in the planned implementation of MRTU will be necessary if undesirable start-up difficulties are to be avoided.

C. FERC's Order

The last critical element MPs must have before they can spend money on vendor development of systems and software is a FERC Order on the proposed MRTU Tariff. In its filing, the CAISO indicated that it expects a FERC order to be issued in the 3rd quarter of 2006. Just as the CAISO needs a FERC order approving its proposed systems at certain stages in order to proceed with MRTU program development, MPs also need this type of assurance to support

²⁸ See, Appendix A, attached to these Reply Comments.

the significant investments they will have to make in software and systems in order to be able to participate in the redesigned market that MRTU will implement. Thus, the issuance of a FERC order is not only necessary for the CAISO to move forward with the final development of its own MRTU software and systems but also for the MPs' development of the software and systems they will need to participate in MRTU.

The CPUC recognizes and commends the CAISO for working with stakeholders on the implementation of MRTU. However, the CPUC urges FERC to approve an implementation schedule for MRTU that is realistic and will allow MPs all the time they will reasonably need to allow for a rational and well-tested transition to the new market. In light of the foregoing concerns about the time that the MPs will need to develop and implement the systems that will be necessary for them to have on-line in order to participate confidently in MRTU, the CAISO should update the MRTU implementation schedule to reflect not only its own requirements for readiness but also the readiness requirements and scheduling needs of the MPs.

IV. THE MRTU MARKET STRUCTURE SHOULD PROVIDE GREATER RELIABILITY FOR LSEs THAT PROVIDE ADEQUATE POWER SUPPLY TO SATISFY LOAD DURING TIMES OF SYSTEM STRESS

PG&E's and SCE's Comments²⁹ propose to modify the MRTU tariff to assure that Scheduling Coordinators ("SC") that self-schedule and/or bid into the CAISO LMP market at least as much energy as their load draws from the grid are given priority in allocation of resources if the CAISO must shed load due to lack of economic bids. The CPUC supports this proposal for a number of compelling reasons: (1) it rewards those LSEs that have procured adequate resources to satisfy their customer base; (2) it lets customers who have paid for procurement of sufficient or excess capacity benefit from that investment; and (3) it prevents

²⁹ See, SCE's Comments, at pages 19-23, and PG&E's Comments, at page 11.

free-ridership by LSEs that fail to procure adequate resources. All of these effects support the CPUC's RA program and its intended goal of a reliable supply of electricity for the state. The CPUC thus urges that the FERC direct the CAISO to modify the tariff accordingly.

As discussed in the CPUC's Comments, implementation of the CPUC's state-mandated Resource Adequacy program is well underway. As a result, LSEs are procuring sufficient capacity to more than cover their anticipated loads. In the event that economic bids are exhausted, however, section 31.4 of the CAISO tariff would effectuate an administrative load curtailment scheme. The CPUC requests that the FERC direct the CAISO to refine this section of the MRTU Tariff by providing a priority to first allocate resources to a SC that bids in or self-schedules resources and covers its load, rather than ignoring the extent to which a SC contributed to the insufficiency of energy supply. Specifically the CPUC supports the following changes to the priority list in Section 34.1:

- i. RMR pre-dispatch
- ii. Day-Ahead TOR
- iii. Day-Ahead ETCs
- iv. Day-Ahead Regulatory Must Run and Regulator Must Take reduction **(switched order with v)**
- v. Other Self Scheduled Load reduction subject to Section 31.3.1.2 **(switched order with iv)**
- vi. Matched Other Supply (Self-Scheduled plus bid-in Supply) and Self-Scheduled Load reduction; and
- vii. Unmatched self-scheduled supply reductions
- viii. Unmatched self-scheduled load reductions
- ix. Economic Demand and Supply Bid.

Also, the CPUC supports PG&E's request that in the event of a non-economic adjustment period the CAISO shall, to the extent feasible, curtail load that is unbalanced and leave intact the balanced self-schedules.

These minor modifications are just and reasonable, and are consistent with the goals of the CPUC's Resource Adequacy program. As the CPUC's Resource Adequacy program promotes the reliability of the state's energy supply by requiring LSEs to procure capacity to cover their load plus an additional planning margin, the CAISO Tariff should be modified as described above to integrate CAISO market rules with state reliability planning policy. These changes will assure LSEs that MRTU will promote reliable service to LSEs that have met their procurement goals, and will prevent LSEs that are not fully self-supplied from leaning on those that are. These tariff changes will help prevent the repetition of the inequitable circumstance that occurred during the California Energy Crisis, when entities that scheduled resources into the PX did not obtain the benefit of those resources during times of system stress.

V. THE CPUC SUPPORTS AN MRTU READINESS CERTIFICATION PROCESS, AND FERC REVIEW OF THAT PROCESS, PRIOR TO THE CAISO'S LAUNCH OF MRTU

The CPUC strongly supports PG&E's proposal for the CAISO to establish a certification process, which should be developed with stakeholder participation, to identify objective performance criteria for all critical elements of MRTU.³⁰ The CPUC recommends that these criteria be applied to the systems and software performance of both the CAISO and market participants. The CPUC also recommends that FERC review the results underlying the CAISO's MRTU readiness certificate, when they are submitted, and issue a determination whether the CAISO's and other market participants' systems are sufficiently functional to go live.

³⁰ See, PG&E's Comments, at pages 3 and 10.

Prior to the launch of the CAISO in 1998, the CEOs of the IOUs in effect certified CAISO readiness.³¹ MRTU implementation involves a major overhaul of the way in which the CAISO performs market operations and a dramatically different market paradigm. Also, the CAISO MRTU has many unique features; it is definitely not “plug and play.” Given the magnitude of the task of implementing such a major new system while, at the same time, continuing to operate the California grid, it is necessary to ensure that MRTU is working, that market pricing software is de-bugged, that all market participants are ready, and above all, that grid operations and reliability will not be adversely affected by the transition.

Finally, the CAISO’s testing and implementation process may benefit from lessons learned from other ISOs/RTOs and from market participants that do business in those other ISOs/RTOs or that have experience with large-scale and complex software implementation. These entities can help to develop objective criteria and to structure a readiness certification process. The CPUC supports PG&E’s recommendation for a FERC technical conference on these issues.

VI. PJM STYLE OF LOCAL MARKET POWER MITIGATION SHOULD BE ADOPTED

Other commentors on the proposed MRTU Tariff, including PG&E, SCE and others, agree with the CPUC that the FERC should adopt a “PJM style” of LMPM. By contrast, WPTF/IEP opposes the use of a “PJM style” of LMPM and suggests the use of a conduct and impact testing procedure (“C&I”) approach. WPTF/IEP fears over-mitigation of price signals that accurately reflect the scarcity of resources, rather than the exercise of market power.³² WPTF/IEP cites no authority, however, for its proposition that market power has been

³¹ See, PG&E’s Comments, at page 3, footnote 1.

³² See, WPTF/IEP Comments filed in this Docket, at pp. 21-23.

effectively curtailed in those ISOs using a C&I method, or that those ISOs' circumstances are sufficiently analogous to create an "apples to apples" comparison that would warrant adopting that particular approach to market mitigation as a model for the California market.

Clearly, over-mitigation of appropriate price signals should be avoided if California is to create market-based incentives to build generation and/or transmission where they are most needed.³³ However, as PG&E states, in California, the risk of over-mitigation is decreased by: (1) the CPUC's Resource Adequacy requirement that LSEs procure 15 to 17% more resources than their anticipated peak load, (2) the CPUC's local resource adequacy requirements ("LRAR") anticipated to take effect in 2007, and (3) the CPUC's long-term resource planning process. Further, generators' claimed revenue insufficiency issues are being addressed by the RCST settlement proposed in FERC Docket Number EL05-146.³⁴

In light of California's very recent history of exercise of market power by generators, FERC must stand firmly by the principle that market pricing in quasi-monopoly industries requires effective market power mitigation.³⁵

VII. ANCILLARY SERVICES SHOULD BE SUBJECT TO LMPM

In its Comments, SCE identifies that there is no Ancillary Services market power mitigation except the bid cap.³⁶ The CPUC is concerned that absent LMPM on Ancillary Services ("AS"), generators may exercise market power that could have a significant financial impact on retail customers. The MRTU Tariff permits the CAISO to modify the boundaries of

³³ *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964, 969 (D.C. Cir. 2005) citing *Maryland People's Counsel v. FERC*, 761 F.2d 780, 788-89 (D.C. Cir. 1985).

³⁴ In that case, several parties, including generators, the CAISO, the CPUC and the IOUs crafted a settlement to replace the FERC must offer obligation (FERC-MOO) with a greater capacity-type payment to compensate generators for their reliability services.

³⁵ *Farmers Union Central Exchange v. FERC*, F.2d 1486, 1509 (D.C.Cir. 1984).

the current AS regions to new Regions and Sub-Regions.³⁷ (The CPUC also agrees with SCE that the CAISO should clearly define all AS Regions and Sub-Regions.) The CAISO is proposing that it may create a new Region or Sub-Region for reliability purposes without any stakeholder process and will inform the market participants of such determinations through a Market Notice. In Regions or Sub-Regions containing load pockets, AS suppliers may have local market power. However, under the MRTU Tariff, LMPM will not apply to AS bids.³⁸ There will simply be a system-wide AS bid-cap.³⁹

Without proper market mitigation, suppliers with market power may bid significantly higher than just and reasonable prices. As a result the Regional and Sub-Regional AS markets may experience anomalous anti-competitive AS prices. To address this possibility, even though it has not squarely addressed this issue in previous orders relating to MRTU or the CAISO Tariff, FERC should order the CAISO to explore the implementation of mitigation measures, such as LMPM, for AS procurement at Regional or Sub-Regional levels.

VIII. CONGESTION REVENUE RIGHTS ALLOCATION MUST ADEQUATELY HEDGE TRANSMISSION COSTS

A. PUC Generally Supports the Principles Behind FERC's Current Rulemaking on Long-Term Firm Transmission Rights

As noted by PG&E,⁴⁰ in a recent Notice of Proposed Rulemaking, Docket No. RM06-8, the FERC proposed to amend its regulations to require Regional Transmission Organizations and Independent System Operators (“RTO/ISOs”) that are public utilities with organized electricity

³⁶ See, SCE's Comments, at page 35.

³⁷ MRTU Tariff § 8.3.3.

³⁸ See, Direct Testimony of Farrokh Rahimi, filed in support of the CAISO's MRTU Tariff in this Docket, at page 112: “...under MRTU, there will be no local market power mitigation for AS (other than the system-wide AS Bid cap). Therefore, creating a more granular AS region within a region that qualifies as a Load pocket has the potential to allow resources within that region to exercise market power.”

³⁹ *Id.*

markets to make available long-term transmission rights that satisfy certain guidelines, to be established in that proceeding pursuant to section 1233(b) of the Energy Policy Act of 2005.⁴¹ To the extent a RTO/ISO could not satisfy all load serving entities' ("LSE") requests for transmission, FERC's proposed regulations in that docket would give allocation priority to LSEs with long-term power supply contracts that are used to meet service obligations. Transmission rights would also accrue to any party that pays for transmission upgrades or expansions, consistent with current practice.

The CPUC believes that the MRTU's planned Congestion Revenue Rights ("CRR") product largely satisfies FERC's proposed criteria for firm transmission rights products. Assuming that the FERC Rulemaking concludes that a multi-year product is necessary, the CPUC expects that the CAISO will respond to the guidelines resulting from the subject NOPR by eventually expanding the CRR program into a multi-year product. MRTU will be introducing an LMP market in California. Because California has had no experience with such a market, the CPUC believes that the MRTU market should be permitted to settle into a steady state before additional changes are implemented.

B. CRR Design Should Address the Long-Term Efficacy of the Allocated Rights As A Hedge Against Congestion Costs

Like SCE,⁴² the CPUC urges that CRRs be designed to avoid their use as an investment by non-MPs, but rather to facilitate the procurement and transmission of energy in California.

"The CRR allocation process should not be a money making machine for speculators."⁴³

Otherwise, ratepayers may pay dearly for profits that fail to create any incentives to invest in the

⁴⁰ See, PG&E's Comments at page 26.

⁴¹ Pub. L. No. 109-58, § 1233(b), 119 Stat. 594, 960 (2005).

⁴² See, SCE's Comments, at page 23.

⁴³ *Id.*

state's electric infrastructure. Like SCE, the CPUC is concerned that the MRTU Tariff eliminates the requirement for LSEs to demonstrate a continued need for the transmission rights after the first year.⁴⁴ Potentially, an MP could obtain a CRR one year, may not need that hedge the next year due to change in generation, transmission or load, but could nonetheless maintain the right to the revenue stream. This situation would disadvantage LSEs using that transmission path to serve load, as such LSEs would have to pay a congestion charge to the LSE that no longer serves load on that path yet still owns the CRR.

The accuracy of the initial allocation of transmission rights is another concern, given the early stages of MRTU and the CPUC's Resource Adequacy program. The reliability of the financial hedge is key to its efficacy. Specifically, the successful creation and allocation of CRRs depend on the CAISO's creation of an accurate computer-generated model of the grid. As discussed elsewhere in these comments, and as noted by other parties in their comments, the CAISO has not yet released details regarding the Full Network Model, which will be the basis for allocation of CRRs. The CPUC believes that this model must be made available to LSEs so that they can accurately forecast their needs for congestion cost hedges and manage their resource portfolios.

C. CRR Renewability After Year One Should Be Increased in Order To Ensure Adequacy Of the CRRs' Efficacy as a Hedge

SCE and PG&E both observe that the MRTU severely limits the allocation of CRR renewals for Year Two.⁴⁵ The CPUC believes that in order to use CRRs to adequately hedge congestion costs and assure LSEs of the deliverability of their contracted resources, LSEs should be permitted to nominate up to 66% of their allocation after Year One.

⁴⁴ See MRTU Tariff, §§ 36.8.3.1-2, 36.8.3.5.

⁴⁵ See, PG&E's Comments at pages 26-28; SCE Comments at pages 24-25.

IX. THE AUTOMATIC RISE IN THE ENERGY BID CAP IS NOT SUPPORTED BY THE RECORD; IT IMPROPERLY BINDS FUTURE COMMISSIONS AND IMPERMISSIBLY DELEGATES THE COMMISSION'S EXCLUSIVE RESPONSIBILITIES

In its Comments, PG&E argues that the Commission lacked sufficient evidentiary record to presume that the post-MRTU market would provide just and reasonable rates.⁴⁶ The CPUC shares these concerns.

A. Background

In its May 2005 Filing in Docket ER02-1656-026, the CAISO proposed to evaluate the competitiveness of the market annually, starting sixteen months after implementation of MRTU, and to recommend incremental, \$250/MWh increases in the energy bid caps to the Commission at each stage (and a transition from the soft to a hard cap) if the market design worked as planned and the market could sustain the increase. This transition could have resulted in gradually increasing the cap from the existing \$250/MWh soft cap up to a final hard cap level of \$1000/MWh.⁴⁷ In its July 1 Order in that Docket,⁴⁸ the Commission rejected the CAISO proposal and instead required the CAISO to adopt automatic energy bid increases, starting with an initial hard cap of \$500/MWh, increasing to \$750/MWh one year later, and reaching the \$1000/MWh two years after implementation.⁴⁹ Deviation from this plan would be permitted only if the CAISO submits a formal filing demonstrating to the Commission's satisfaction that the market is not competitive.⁵⁰

⁴⁶ See, PG&E's Comments at page 19.

⁴⁷ See, the CAISO's May 2005 Filing, at pages 9-10, 35-37.

⁴⁸ *Order On Further Amendments To The California Independent System Operator's Comprehensive Market Redesign Proposal* issued in Docket No. ER02-1656-026 on July 1, 2005 ("July 1 Order").

⁴⁹ See, July 1 Order, at ¶ 104.

⁵⁰ *Id.*

The CPUC requested rehearing of the July 1 Order matter on the grounds that: (1) the automatic nature of this rise in energy bid caps exceeds the Commission's authority; (2) it is not based on any facts in the record; (3) it precludes the admission of facts that would be relevant to the analysis of whether to raise energy bid caps (i.e., market conditions after the implementation of MRTU); and (4) it is contrary to Commission precedent and policy. In response to this rehearing request, the Commission ruled that "the mitigation package approved in principle for the MRTU, in combination with strong market behavior rules and the must-offer obligation for Resource Adequacy resources, is sufficient to prevent the exercise of market power."⁵¹

B. The Record Does Not Support the Conclusion that Market Based Rates Will Ensure Just and Reasonable Rates at Specific Points After the Implementation of MRTU

The Commission must base its decisions on facts in the record that support its conclusion.⁵² In order to determine whether market-based rates will ensure just and reasonable rates, the Commission must analyze the prevailing market conditions.⁵³ The Commission has been informed by the CAISO in this proceeding that "the California marketplace is still struggling with the remnants of the energy crisis...".⁵⁴ An early, relatively less complex stage of MRTU, the subject of the Amendment No. 66 proceeding in Docket No. ER05-718, resulted in settlement problems.⁵⁵ Ample evidence thus shows that unanticipated circumstances, including market instability and market power, may arise after implementation of a new market

⁵¹ *Order On Rehearing* issued in Docket No. ER02-1656-029 on September 19, 2005 ("September 19 Order"), at ¶ 39.

⁵² *Michigan Public Power Agency v. FERC*, 405 F.3d 8, 9 (D.C. Cir. 2005)("MPPA") (Commission's decisions must be based upon "reasoned decision making[.]"), *California Dept. of Water Resources v. FERC*, 341 F.3d 906, 910 (9th Cir. 2003)("CDWR") (it must "appear on th[e] record that FERC has considered all of the relevant factors in reaching its decision.").

⁵³ *Lockyer v. FERC* 383 F.3d 1006, 1015-6 (9th Cir. 2004)("Lockyer").

⁵⁴ See the CAISO's May 2005 Filing, at page 10.

⁵⁵ See, July 1 Order at ¶¶ 50-51, 69-70.

structure. Further, nothing in this docket could provide the Commission with the factual basis necessary to determine whether months or years after MRTU implementation, the California energy market will be sufficiently competitive to warrant increases in the energy bid cap.

C. Future Uncertainties Preclude “Springing” Bid Cap Decisions.

Even if the Commission could predict future market conditions, it would be improper for this Commission to make a decision that will become effective well beyond its own tenure. “[T]his Commission cannot bind future Commissions.”⁵⁶ While the Commission can, and should, establish standards and provide guidance as to the application of those standards, it may not render an order based upon the application of, or assumptions about, future facts to those standards. Rather, it is within this Commission’s discretion to require the CAISO to submit its proposals for the appropriate bid cap level every year, and even to require the CAISO to explain why the proposed level is not at the projected expectation. However, it is not within the power of this Commission to predetermine how future Commissions should rule on future submissions.

D. This Commission Cannot Delegate Its Exclusive Responsibilities.

It is this Commission’s responsibility under the Federal Power Act to approve just and reasonable rates.⁵⁷ Because the Commission’s jurisdiction to determine whether rates are just and reasonable is exclusive, it may not assume that the rates that it approves will be just and reasonable and delegate the responsibility to another entity to submit a filing if this Commission’s assumptions are not borne out.⁵⁸ This Commission would “abdicat[e] its

⁵⁶ *Declaratory Order Providing Guidance Concerning Grid West Proposal* filed in *Bonneville Power Administration et al.*, Docket No. EL05-106-000, 112 FERC ¶ 61,012 at ¶ 66 (citing *Wyoming-California Pipeline Co.*, 45 FERC ¶ 61,234, 61,678 (1988) and *Union Pacific Fuels, Inc. v. FERC*, 129 F.3d 157 (D.C. Cir. 1997)).

⁵⁷ FPA § 205(a), 16 U.S.C. § 824d(a).

⁵⁸ *Lockyer*, 383 F.3d at 1011 (citing *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 371, 108 S.Ct. 2428 (1988)).

regulatory responsibility” and undermine the principles underlying market-based tariffs if it declined to monitor the markets itself or to take remedial action when warranted.⁵⁹

E. This Commission Should Respect Precedent and Should Not Blindly Adopt Measures from Other Control Areas.

The bid cap and other market power mitigation measures currently in effect in the West differ significantly from those approved elsewhere in the country. These differences reflect the reality that California, as part of an interconnected region subject to distinct market conditions, is different from other areas and must be treated as such.⁶⁰ The Commission stated in 2002 that as it “continues its monitoring and evaluation of the health of the Western energy markets and additional elements of the California market redesign proposal are implemented, [it] will consider increasing the bid cap to reflect market conditions.”⁶¹ By requiring the CAISO to propose an ultimate bid cap of \$1000, without having determined that the levels approved in the eastern ISO/RTOs are appropriate for California, this Commission would apply a “one size fits all” approach to a situation that clearly requires a particularized or context-specific analysis. For the reasons stated above, a determination by the Commission in this case that would have the effect of requiring the CAISO to adopt automatic energy bid increases would constitute legal error.

⁵⁹ *Lockyer* at 1015-1016.

⁶⁰ See, e.g., *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Service*, “Order On Rehearing Of Monitoring & Mitigation Plan For The California Wholesale Electric Markets, Establishing West-Wide Mitigation, & Establishing Settlement Conference,” Docket No. EL00-95-031 et al., 95 FERC ¶ 61,418 at 6 (June 19, 2001); “Investigation Of Wholesale Rates Of Public Utility Sellers Of Energy And Ancillary Services In The Western Electricity Coordinating Council,” Docket No. ER02-1656 et al., 100 FERC ¶ 61,060 at ¶¶ 2, 49 (July 17, 2002)(the “July 2002 Order”)(imposing current bid cap).

⁶¹ See, July 2002 Order, at ¶ 48.

X. THE CPUC SUPPORTS THE REQUEST FOR A TECHNICAL CONFERENCE ON THE ALLOCATION OF MARGINAL TRANSMISSION LOSSES

The CPUC re-states a point made in its Comments, and supports PG&E's call for a Technical Conference on the allocation of marginal transmission losses. The allocation of excess marginal transmission losses was a development that occurred toward the very end of the MRTU stakeholder process in 2005, and the CAISO's proposal on this subject is accordingly in need of refinement. It makes sense for FERC to schedule a Technical Conference to determine if the CAISO's proposal on this subject could be updated to make it more equitable. Moreover, this Technical Conference should be convened in time to allow for an updated provision on the allocation of marginal transmission losses to be included as part of MRTU Release 1.

XI. DEMAND RESPONSE SHOULD BE ADDRESSED AS SOON AS POSSIBLE, BEFORE RELEASE 2

The CPUC agrees with PG&E's concerns that the CAISO is waiting too long to address demand response issues and that these issues should be treated on an accelerated basis rather than waiting until Release 2.⁶² The energy agencies in California (the CPUC and the California Energy Commission) have adopted a loading order, which places a priority on the development of demand side and renewable resource development. It is therefore incumbent upon the CAISO to integrate such resources into the MRTU market design without delay. The CPUC Resource Adequacy program allows for Demand Response resources that meet certain deliverability criteria to count as qualifying resources, but the CAISO's market rules do not fully reflect this policy. It is accordingly a matter of the highest priority for the CAISO accelerate its work on Demand Response prior to Release 2.

⁶² On page 96 of the Transmittal Letter accompanying the filing of the MRTU Tariff in this docket, the CAISO states that it plans to address participating load demand response in the Day-Ahead market as a Release 2 item.

The CPUC observes that the CAISO has accelerated the virtual bidding stakeholder process. Likewise, there is no compelling reason why the CAISO cannot accelerate its efforts on the integration of Participating Load Demand Response into the MRTU market design on the same track.

XII. THE CAISO'S PROPOSED REQUIREMENT OF 45 DAYS' NOTICE FOR TRANSMISSION OUTAGES IS UNREASONABLE AND UNWISE

The CAISO's proposed MRTU Tariff would increase the minimum notice required for transmission maintenance outages from 72 hours to 45 days. The purpose of this increase in notice is to "incorporate outage information into the Full Network Model" for determining availability and monthly release of CRRs.⁶³ PG&E and SCE object to this drastically increased notice requirement as unnecessary, unreasonable, and unwise.⁶⁴ The Western Area Power Administration ("WAPA") also objects to the increased notice provision.⁶⁵ The CPUC agrees with these entities that the 45-day notice provision is unreasonable and supports the alternative proposal suggested by SCE and PG&E.

SCE, PG&E, and WAPA state that adoption of a minimum 45-day notice requirement will decrease the ability of participating transmission owners to prioritize transmission jobs and assign resources efficiently. SCE and WAPA state that it would be costly and inefficient to require 45 days' notice of all transmission maintenance jobs because some circumstances affecting the scheduling of transmission maintenance, such as weather conditions and unscheduled outages, cannot be reliably planned for 45 days in advance.⁶⁶ Thus, a 45-day notice

⁶³ See, CAISO's May 2005 Filing in this Docket, at page 92.

⁶⁴ See, PG&E's Comments, at page 14; SCE's Comments, at pages 28-30.

⁶⁵ See, WAPA's Comments filed in this Docket, at pages 23-24, 69.

⁶⁶ See, SCE's Comments, at page 29; WAPA Comments, at page 69.

requirement would delay maintenance operations, increase maintenance costs, increase forced outages, and actually threaten system reliability.⁶⁷

SCE and PG&E propose as an alternative that a 45-day notice requirement apply only to scheduling or rescheduling of approved long-range outages, while allowing participating transmission owners to schedule or reschedule approved short-term outages up to 72 hours in advance, as permitted by current rules.⁶⁸ SCE argues further that short-term outages (those lasting only a day or two) would have little impact on the value of CRRs.⁶⁹ This alternative proposal appears to be a reasonable compromise between accuracy of CRR allocations and scheduling of necessary maintenance, and the CPUC supports it.

⁶⁷ See, SCE's Comments, at page 29; WAPA Comments, at page 23.

⁶⁸ See, SCE's Comments, at page 30; PG&E Comments, at page 14.

⁶⁹ See, SCE's Comments at pages 28-29.

CONCLUSION

The CPUC respectfully submits that the Commission should seriously consider the foregoing Reply Comments in this proceeding.

May 16, 2006

Respectfully submitted,

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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 16th day of May 2006.

/s/ Elizabeth D. Dorman

Elizabeth D. Dorman

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

California Independent System)
Operator Corporation)
_____)

Docket No. ER06-615-000

APPENDIX A

TO

REPLY COMMENTS
OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION
ON THE CALIFORNIA ISO'S MRTU TARIFF

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