

STATE OF CALIFORNIA

ARNOLD SCHWARZENEGGER, *Governor***PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

June 15, 2007

VIA E-FILINGKimberly D. Bose, Secretary
Office of the Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426**Re: California Independent System Operator Corporation, Docket Nos. ER06-615-000 and ER07-869, Motion For Leave To Answer And Answer of the California Public Utilities Commission Regarding California Independent System Operator's May 7th, 2007, Filing Regarding Congestion Revenue Rights Allocation And Auction Under MRTU**

Dear Ms. Bose:

Enclosed for e-filing in the above-docketed cases, please find an original electronic filing of the attached document entitled "Motion For Leave To Answer And Answer of the California Public Utilities Commission Regarding California Independent System Operator's May 7th, 2007, Filing Regarding Congestion Revenue Rights Allocation And Auction Under MRTU."

Thank you for your cooperation in this matter. Please feel free to contact me at the telephone or e-mail address listed below should you have any concerns with this filing.

Sincerely,

/s/ Elizabeth DormanElizabeth Dorman
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**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System Operator
Corporation

Docket Nos. ER06-615,
ER07-869

**MOTION FOR LEAVE TO ANSWER AND ANSWER OF THE
CALIFORNIA PUBLIC UTILITIES COMMISSION REGARDING
CALIFORNIA INDEPENDENT SYSTEM OPERATOR'S MAY 7TH, 2007,
FILING REGARDING CONGESTION REVENUE RIGHTS ALLOCATION AND
AUCTION UNDER MRTU**

I. MOTION

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”), the Public Utilities Commission of the State of California (“CPUC”) hereby moves for leave to and answers the protest of San Diego Gas & Electric (“SDG&E”) filed on May 29, 2007, (“SDG&E Protest”); Southern California Edison’s (“SCE”) Answer to the Protests of SDG&E and other organizations, filed on June 13th, 2007 (“SCE Answer”); and the California Independent System Operator’s (“CAISO”) Answer to Comments (“CAISO Answer”), filed on June 14th, 2007, all in the instant dockets.¹

Rule 213 generally bars answers to protests. The Commission may, however, accept such answers that provide additional information that will assist it in its decision-

¹ The SCE Answer and SDG&E Protest were filed only in FERC Docket No. ER07-869, while the CAISO Answer was filed in both of the above-captioned dockets.

making process.² The CPUC's comments provide such assistance by elucidating problems with SDG&E's Alternative One proposal and revealing additional benefits arising from SDG&E's Alternative Two proposal. The CPUC also responds to aspects of the SCE and CAISO Answers, clarifying strengths and weaknesses in some of SCE's arguments and CAISO's responses to the CPUC's requested modifications. Accordingly, the CPUC moves for leave to file this answer to the SDG&E Protest, the SCE Answer and the CAISO Answer and submits the following comments.

II. COMMENTS

SDG&E protested aspects of the CAISO's May 7, 2007, amendments to tariff language submitted to allow the allocation of Congestion Revenue Rights ("CRR") in its Market Redesign and Technology Upgrade ("MRTU") tariff. In this answer, the CPUC supports SDG&E's Alternative Two³, which would provide for expiration of priority to renew source-based CRRs upon the expiration of the source contract; and opposes its Alternative One,⁴ which would allow LSEs to obtain CRRs based upon energy supply contracts not yet in operation in 2006. The CPUC also addresses arguments submitted in the SCE Answer to the Protests of SDG&E and other organizations, filed at FERC in the instant dockets on June 13th, 2007, as well as the CAISO's responses to the CPUC's suggested modifications.

The CPUC believes that CAISO's proposed method of allocating LT CRRs creates significant risk that LSEs will not be able to secure adequate financial hedges for

² See e.g., *Transcontinental Gas Pipe Line Corporation*, (2006) 117 FERC ¶ 61,136 at p. 4, accepting an answer to a protest because it provided information assisting FERC in its decision-making process.

³ SDG&E Protest at p. 27.

⁴ SDG&E Protest at p. 24.

future energy resources to be built in remote locations. The CPUC also believes that Alternative Two suggested in the SDG&E Protest would work well together with the CPUC's suggested modifications to the CAISO's proposed CRR allocation methodology. Conversely, the CPUC believes that SDG&E's Alternative One would impede the entry of new generation sources into the California energy market at least as much as the CAISO's proposed methodology, if not more so. Therefore, the CPUC requests that FERC order the modifications of the CAISO's proposed tariff language consistent with the CPUC's recommendations discussed in its limited protest and SDG&E's proposed Alternative Two. In sum, the CPUC asks the FERC to order the CAISO to modify its CRR methodology to 1) lower the percentage of LSEs' load that can be converted to long-term CRRs,⁵ and 2) end LSEs' priority renewal of CRRs based on expired contracts.

A. Implementation of SDG&E's "Alternative Two" Would Facilitate The Addition Of New Generation Resources And California's Choice To Increase Its Reliance Upon Renewable Energy Resources.

The SDG&E Protest asserts that the CAISO's proposed CRR allocation methodology is unjust and unreasonable, and as a remedy, proposes two alternative remedies. SDG&E argues in its Alternative Two that LSEs' ability to renew CRRs allocated based on verified source contracts should be limited to the duration of that original contract.⁶ The CPUC supports this proposal because it would limit the extent to which LSEs could keep CRRs that they are not using, and which would be used and

⁵ The CPUC maintains the proposition, as stated in its Intervention and Limited Protest filed in this docket on May 29th, 2007, that CAISO should maintain the proposed limit of 50% of an LSE's Adjusted Load Metric where its CRRs nominated to be long-term CRRs are supported by minimum ten-year contracts or where the LSE owns the generation resource.

⁶ SDG&E Protest at p. 4.

useful by another LSE that is delivering energy using those sources and sinks. This effect would, the CPUC anticipates, facilitate the release of CRRs to hedge new generation resources that will added to the grid over time, enabling new resources to enter energy supply contracts on an equal footing with existing resources.

As observed by Dr. Lorenzo Kristov, the CAISO's filed proposal does not provide for source verification for CRR allocations after CRR Year One.⁷ Dr. Kristov asserts that the absence of source verification in future years benefits LSEs' ability to hedge congestion costs in that they can obtain CRRs to hedge future contracts "without . . . any priority, advantage, or guarantee of being allocated CRRs . . .[.]"⁸ If in fact this lack of any priority based on energy supply contracts is an advantage to LSEs, such an advantage should be spread equally between LSEs that had energy supply contracts delivering in 2006 and those that did not. If, however, the lack of contract-based priority in allocation of CRRs is a detriment to individual LSEs, that detriment should also be spread evenly among LSEs. FERC approval of either the CAISO's proposal or SDG&E's Alternative One could thus codify an unjust and unreasonable tariff in that LSEs would be arbitrarily prejudiced or benefited based on whether they had contracts delivering energy in 2006 along congested paths.⁹ Such prejudicial effects could continue for decades due to LSEs' ability to nominate up to 50% of their seasonal, non-source verified CRRs into long-term CRRs.

⁷ CAISO Exhibit No. ISO-1 at p. 51.

⁸ CAISO Exhibit No. ISO-1 at p. 51.

⁹ Congested paths will likely result in the CRR holder for that source and sink combination obtaining a greater income flow from that CRR than a less congested path.

SCE argues that Alternative Two is flawed because it “ignores completely the fact that the LSE may continue to need those rights as a hedge in future years[.]” because the LSE’s load will not have decreased.¹⁰ SCE admits, however, that “all LSEs . . . face the issue of hedging a future portfolio of resources that is not the same as the portfolio utilized in the historic period[,]” and that the LSE may serve its load “from other points on the grid completely.”¹¹ “In fact, arguably all of the LSEs in California have and will likely continue to change their procurement practices in the future.”¹² SCE thus admits that any LSE holding a CRR based on an expired contract will likely need a different CRR over time from that it obtained through source verification of 2006 grid usage.

SCE staff has informed the CPUC staff that because the CAISO’s proposed methodology will limit LSEs’ ability to regain any given CRR once it is lost, its choices of energy supply contracting partners will be impacted by which CRRs it already holds and can retain over time. The CAISO’s proposed methodology would largely limit LSEs with new energy supply contracts to *buying* CRRs from LSEs that no longer source from a given generator but continue to be *given at no cost* CRRs sourced at that generator. The failure to roll-off LSEs’ priority as energy supply contracts expire may inadvertently incent an LSE to keep the most valuable CRRs, even if it is not longer using that source and sink combination, in order to make money to buy on the secondary market CRRs for the source and sink combinations they will be using in the future, a form of cherry-picking of revenue rights.

¹⁰ SCE Answer at p. 4.

¹¹ SCE Answer at p. 4.

¹² SCE Answer at p. 4.

The CAISO acknowledges the potential for such effects arising from its proposed methodology, stating that “because the availability of Long Term CRRs in the future will depend in large part on Market Participant behavior that cannot confidently be predicted at this time, it is . . . not possible to predict definitively whether the CAISO’s filed rules will unduly hamper the ability of LSEs and OCALSEs [Out of Control Area LSEs] to obtain the mix of short-term and Long Term CRRs that best meets their needs.”¹³

The CPUC recommends against adopting any alternative with such potential anticompetitive effects. Rather, the CPUC believes encouraging turnover in CRR allocation and ownership will result in a robust secondary market for CRRs, in which LSEs with new energy supply contracts will be able to negotiate on a relatively even playing field with those LSEs that had contracts in 2006.

“LSEs do have the ability to select those Seasonal CRRs of their current holdings that they deem to be most valuable and nominate those for renewal in the [Priority Nomination Tier, or] PNT before any LSEs can nominate CRRs from sources that are not part of their current holdings.”¹⁴ This methodology, Dr. Kristov states, “can allow an LSE to hold onto or ‘lock up’ valuable CRRs that it obtained via a verified source in CRR Year One but no longer needs in conjunction with the actual supply resources it is using to serve its load.”¹⁵ Such speculative behavior, though contrary to the intended function of CRRs to hedge each LSEs actual congestion costs, is not prevented by the CAISO’s proposed methodology. The CAISO further concedes that “limiting the overall

¹³ CAISO Answer at pp. 9-10.

¹⁴ Attachment D, Testimony of Dr. Lorenzo Kristov, Exhibit No. ISO-1, at p. 52.

¹⁵ Attachment D, Testimony of Dr. Lorenzo Kristov, Exhibit No. ISO-1, at p. 52.

percentage of LSEs' and OCALSEs' load that is eligible to obtain Long Term CRRs in CRR Year One¹⁶ would make an important contribution to the ability to obtain sufficient CRRs in subsequent years to manage the congestion costs associated with new resources[.]”¹⁷ The CAISO therefore concedes that the CPUC's suggested modifications would facilitate implementation of California's renewable energy procurement goals.¹⁸

The CPUC could arguably provide input on whether LSEs subject to its jurisdiction may engage in such hoarding of unneeded hedges, providing some measure of correction of such potential problems. But the lack of such prohibition on non-CPUC jurisdictional entities would create inequities in LSEs' relative ability to engage in profiteering from CRR speculation. Therefore, the Commission must correct the problem to prevent any LSE from unfairly profiting from prior contract ownership or usage at the expense of an LSE attempting to hedge its expected transmission costs.

The CPUC believes the modifications suggested in these comments will address the aforementioned concerns. By reducing the number of unverified short term CRRs that can be converted to LT CRRs, the CAISO will decrease the ability of LSEs holding CRRs not related to current or future grid use to impede other LSEs from obtaining well-tailored hedges. Further, by eliminating LSEs' ability to obtain priority renewal of source verified CRRs once the source contract expires, the CAISO would increase the availability of unused CRRs for those LSEs that will use them in the future as a hedge for energy procurement costs. These changes would not significantly hamper the timely

¹⁶ The CAISO provided this statement in response to the CPUC's suggested modification to the CRR allocation and renewal methodology.

¹⁷ CAISO Answer at p. 10.

¹⁸ CAISO Answer at p. 10.

startup of the MRTU market, but would greatly facilitate California's efforts to protect its valuable resources and priceless environment.¹⁹

B. The CPUC Opposes SDG&E's "Alternative One."

The CPUC opposes SDG&E's Alternative One for several reasons, based on both practical and policy/jurisdictional concerns. Alternative One threatens to impede the allocation of CRRs to hedge congestion arising from generation resources added to the grid in the future equally, if not more than, the CAISO's proposed methodology.

SDG&E's Alternative One in essence would allow it to be allocated CRRs based on contracts signed prior to 2007, but that are not scheduled to deliver energy until potentially years later. As discussed in the SCE Answer, this process would in effect hold back CRRs from LSEs that are currently delivering energy over a particular source and sink combination and give that flow of income to an LSE that will not use that path for years, and perhaps not ever.²⁰ Alternative One also, as observed by SCE, threatens to give two LSEs each a legitimate claim to the same CRR.²¹ This could result in unnecessary litigation at FERC, and one or both of those LSEs may necessarily be left without an effective hedge.

The CPUC anticipates that under either the CAISO's or SDG&E's Alternative One methodology for CRR allocation, LSEs will face a financial barrier preventing them from committing to purchase energy from new sources of power, such as renewable energy sources. SDG&E's Alternative One increases the impediment to the addition of

¹⁹ CAISO Answer at pp. 11-12.

²⁰ SCE Answer at p. 3.

²¹ *Ibid.*

new CRRs to hedge new resources because it calls for the allocation of CRRs for generation resources before they become energized and functional in the grid. Thus, an LSE could obtain CRRs that may never come into operation. This allocation would create phantom CRR congestion by preventing LSEs that will actually be delivering energy using that source and sink combination, due to their use of a generator near the not-yet-operational generator, from obtaining a CRR to hedge its congestion costs.

Such an impediment threatens the CPUC's jurisdictional power to select the types of resources that will fuel California load in the future, as well as the ability of proposed new resources to obtain financing for development.²²

III. CONCLUSION

For the reasons discussed above, the CPUC respectfully requests that FERC grant the relief requested herein in combination with the remedies requested in the CPUC's Notice of Intervention and Limited Protest, filed in these dockets on May 29, 2007. Specifically, the CPUC requests that the FERC order the CAISO to modify its CRR allocation and renewal methodology to:

- 1) limit an LSE's allocation of Long Term CRRs to a maximum of 20% of the LSE's adjusted load metric to the extent the LSE's nominations are not supported by evidence of either a contract of 10 years or greater length or ownership of the generation source, and

²² See e.g., Decision ("D.") 05-10-042, Opinion on Resource Adequacy Requirements at pp. 8-9, ["The fundamental premise for developing an RA requirement is to ensure that California maintains a reliable electric system by putting in place a resource adequacy construct that serves, first and foremost, to provide the appropriate incentives for new investment in infrastructure" quoting Opening Comments of Constellation] available at http://www.cpuc.ca.gov/word_pdf/FINAL_DECISION/50731.doc.

- 2) extinguish an LSE's ability to obtain priority renewal of seasonal CRRs based on verified source contracts once the source contract expires (SDG&E's Alternative Two).

Dated: June 15, 2007

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served electronically according to Rule 385.2010(f) of the Commission's Rules of Practice and Procedure.

Dated at San Francisco, California, this 15th day of June, 2007.

/s/ Elizabeth Dorman
Elizabeth Dorman

Submission Contents

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