

On October 28 the Federal Energy Regulatory Commission issued an order on the CAISO's July 2003 market redesign proposal. The order responded to the CAISO's request for Commission guidance on several market elements, many of which will be discussed today.

Briefly, the Commission approved a security-constrained integrated forward market and locational pricing to manage congestion. The proposed full network model will create a detailed and accurate model of the transmission grid to identify constraints so that the CAISO can adjust schedules accordingly – thus eliminating the acceptance of infeasible transmission schedules, and the distinction between inter- and intra-zonal congestion.

According to the CAISO and various market monitoring reports, the current zonal congestion management policy has resulted in increasing intra-zonal congestion costs, inefficient dispatch, and opportunities for manipulative trading strategies. The Commission approves of the CAISO's proposed congestion management system, which would solve these problems and create greater transparency.

With this new design, the CAISO will be able to

- recognize all transmission bottlenecks so that schedules submitted in the day-ahead time frame can actually fit on the grid in real time,
- allocate the use of limited transmission facilities to energy buyers and sellers in a non-discriminatory and efficient manner, and
- make the best use of transmission and generation resources to serve load and provide system reserves on a least-cost basis.

The Commission also supports the CAISO's proposal to charge load an aggregated price. This is a reasonable approach to introducing locational pricing while minimizing impact on load, and this approach has proven successful in other markets.

In order to preserve existing rights and to provide customers an opportunity to protect themselves from the financial impacts of congestion, the Commission supports the adoption of Congestion Revenue Rights as a risk management tool. Both the Commission and market participants need further information on the allocation of rights, and in its order the Commission required the CAISO to continue to work with parties and to file detailed information on the proposed first year allocation when it files its proposed tariff.

Existing transmission contracts also pose transitional issues for any market redesign. The CAISO has attempted to address these issues through CRRs. However, there are still concerns remaining regarding the transition to the redesigned market, particularly the reservation of unused capacity after the day-ahead time frame. The Commission's preference is that this unused capacity or "phantom congestion" should be alleviated to the extent possible, in a way that is

consistent with contractual rights. The CAISO has committed to working collaboratively to resolve this issue, and we encourage the CAISO and market participants to continue to work together towards a solution.

In ensuring that sufficient resources will be available to meet its load forecast, the CAISO has been relying on the ad hoc waiver process associated with the must-offer obligation. This process has served as a rudimentary unit commitment tool for the CAISO, and has proven to be problematic in its application. The proposed residual unit commitment process will provide a more rational and transparent unit commitment tool for the CAISO to ensure reliability at least cost. The Commission supports this approach.

Regarding the issues of mitigation and resource adequacy, the Commission stated it believes the various elements of a regional market should work well together to produce an efficient, well-functioning wholesale market for the benefit of customers over the long term. There are important inter-relationships among wholesale market elements such as the energy market design, the system for managing congestion, resource adequacy provisions, and the means for mitigating market power. Achieving an appropriate balance among these factors is critical to a well-functioning wholesale market. As part of this balance, market power mitigation should address market power concerns without undermining incentives for new entry and long-term resource adequacy.

The Commission wishes to ensure that the CAISO will have the appropriate tools at its disposal to protect against the exercise of market power. With this backdrop, the Commission decided the best avenue to address the CAISO's proposed mitigation was to have a technical conference that will build upon discussions begun here today. The Commission, however, offered guidance in several respects.

First, the Commission modified the proposed must-offer obligation to require that generators offer in the real-time market unless the CAISO finds they are not needed in the day-ahead market. In its order, the Commission invited further discussion of this proposal among market participants and the CAISO.

Second, the Commission found that issues such as resource adequacy and market power mitigation should not be dealt with in isolation. Without the benefit of a complete market redesign proposal, the Commission cannot make informed decisions on all aspects of the CAISO's proposal – decisions that impact the ability and incentive to forward contract, the reliable operation of the grid, and the ability to attract and retain investment.

In summary, the CAISO's proposed comprehensive market redesign represents major improvements in how the CAISO operates the grid.

The changes are designed to fix flaws and encourage desirable market behavior, and the market is designed so that market rules closely support grid operations. The ultimate goal is a robust and competitive spot market that enhances reliability and lowers costs.

The Commission has acted in recent orders to provide some preliminary guidance and to foster a continuing and collaborative process to complete this market redesign effort. We are here in this technical conference prepared to further the process, and it is our hope to flesh out some of the pertinent issues with the panels here today. We will end today with perhaps not all of the answers, but at least a process for how to move forward in the areas where we have outstanding issues and questions.