

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeem G. Kelly.

California Independent System Operator
Corporation

Docket Nos. ER02-1656-000
ER02-1656-007
ER02-1656-026
ER02-1656-029

ORDER ON REHEARING AND TECHNICAL CONFERENCE

(Issued November 14, 2005)

1. In this order, the Commission addresses matters discussed at a Technical Conference held in San Francisco on September 13, 2005, including issues related to the California Independent System Operator Corporation's Market Redesign and Technology Upgrade (MRTU) Proposal, demand response, Special Case Nodal Pricing (SCNP), and the creation of Load Aggregation Point (LAP) zones for specific wholesale customers. As discussed below, participants in the Technical Conference were invited to submit comments which have formed the basis for our decision on the issues. We conclude that we will not require the CAISO to include SCNP in its tariff at this time. We have also reconsidered the issue of the establishment of LAP zones for specific wholesale customers and conclude that for Release 1 of the CAISO's MRTU Proposal, we will not require the CAISO to facilitate the establishment of separate LAP zones for specific wholesale customers.

I. Background

2. On July 1, 2005, the Commission issued an order approving in principle the MRTU Proposal submitted by the CAISO in the above-captioned proceeding.¹ Among other determinations, the July 1 Order directed Commission Staff to hold a technical conference "to explore demand response options in California," including SCNP.²

¹ *California Independent System Operator, Inc.*, 112 FERC ¶ 61,013 (2005) (July 1 Order).

² July 1 Order at P 39.

Consequently, on September 13, 2005, Commission Staff convened a technical conference to explore CAISO tariff issues related to demand response options, including SCNP and the establishment of LAP zones for specific wholesale customers.³ Participants and parties were invited to submit post-technical conference comments and reply comments.⁴

3. On September 19, 2005, the Commission issued an order on rehearing of the July 1 Order,⁵ in which it deferred ruling on requests for rehearing concerning the issue of establishment of separate LAP zones for wholesale customers until the issuance of the order following the technical conference.⁶ In this order, we will also address issues raised in these requests for rehearing.

4. The following parties submitted comments following the technical conference: the Metropolitan Water District of Southern California (Metropolitan), the California Department of Water Resources State Water Project (SWP), the CAISO, the California Public Utilities Commission (CPUC), Bay Area Municipal Transmission Group (Bay Area Municipals),⁷ the Northern California Power Agency (NCPA), San Diego Gas & Electric Company (SDG&E), the Cities of Anaheim, Azusa, Banning, Colton, Pasadena and Riverside (Southern Cities), Southern California Edison Company (SCE), and Pacific Gas & Electric Company (PG&E). Reply comments were filed by the following parties: SWP, California Municipal Utilities Association (CMUA), NCPA, the Southern Cities, SCE, Energy Users Forum (EUF),⁸ and the CAISO.

³ See Notice of Technical Conference, Docket Nos. ER02-1656-000 and ER02-2656-026, (August 22, 2005); Supplemental Notice of Technical Conference, Docket Nos. ER02-1656-000 and ER02-1656-026 (September 8, 2005).

⁴ See Notice of Deadlines for Comments and Reply Comments, Docket Nos. ER02-1656-000 and ER02-1656-026 (September 23, 2005).

⁵ *California Independent System Operator, Inc.*, 112 FERC ¶ 61,310 (2005) (September 19 Rehearing Order).

⁶ *Id.* at P 22.

⁷ Bay Area Municipals include the Cities of Alameda, Palo Alto and Santa Clara.

⁸ EUF also filed a motion to intervene in this proceeding. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the filing of a timely unopposed motion to intervene serves to make the movant a party to the proceeding.

5. We note that several parties, in their initial and reply comments, conflated the issue of the establishment of specific LAP zones for wholesale customers with the related, but distinct, issue of the appropriate number of geographic zones for LAP.⁹ The latter issue was addressed in the July 1 Order and the September 19 Rehearing Order.¹⁰ Accordingly, we do not address here those issues raised by commenters related to the appropriate number of geographic LAP zones.

II. Discussion

A. Demand Response

6. PG&E notes that the technical conference included a wide-ranging conversation regarding the status of demand response in California and the extent to which demand response is supported by the CAISO tariff. In addition, SCE, PG&E and SDG&E respectively, described various electric demand response programs offered to its participating customers.¹¹ SWP also provided information concerning its ability to provide demand response under certain conditions and indicated its support for allowing pump loads identified in a Participating Load Agreement to be settled at the nodal price when providing demand response.¹²

7. The CPUC notes that at the technical conference it made a formal presentation on the state of demand response in California addressing current state policy, actions taken to date and issues to address in the future. It represents that: (1) demand response has been and remains an important component of the CPUC's broad energy policy for the

⁹ See Initial Comments of NCPA, Bay Area Municipals, Metropolitan, SWP and EUF's Reply Comments.

¹⁰ See July 1 Order at P 35 (noting that "the CAISO has suggested it will re-examine the appropriate number of zones following the release of CRR Study 2"); September 19 Rehearing Order at P 20 (directing the CAISO to re-examine its proposed LAP zones and further disaggregate the zones).

¹¹ See SCE Comments at pp 8-11, SDG&E Comments at pp 2-3. PG&E provides a description of its demand response programs at: www.pge.com/biz/demand_response/.

¹² SWP states that as a pumping load, its primary function is to perform water management activities and that power production is simply a byproduct. SWP states that it can provide limited demand response to the extent water deliveries, environmental requirements and flood protection permit. However, it notes that while it has the ability to respond to dispatch instructions concerning curtailment, it is limited in its ability to respond to CAISO instruction with regard to responding to increased energy consumption.

state; (2) the CPUC has achieved significant demand response accomplishments; (3) the CPUC will continue to be active in demand response, particularly with regard to cost/benefit analyses; and (4) the CAISO and the Commission have a limited role in demand response. CMUA states that market efficiencies may be gained through the introduction of price-responsive demand in the CAISO energy markets.

8. The CAISO describes its Participating Load Program and the opportunities for demand bidding under MRTU.¹³ According to the CAISO, Participating Loads that wish to engage in demand bidding opportunities are required to demonstrate their effective dispatch capability; Participating Loads may participate in the ancillary services markets and receive a capacity price for providing non-spinning reserves. According to the CAISO, in the forward market, if a Participating Load is scheduled, its energy consumption will be charged the day-ahead Locational Marginal Price (LMP) at the pump node. The CAISO further states that in the real-time market, Participating Loads that are dispatched by the CAISO for purposes of demand reduction will earn the real-time nodal price (rather than the LAP price) for that portion of load reduction that is dispatched in real-time.¹⁴ The CAISO concludes that the Participating Load Program in place upon implementation of MRTU is adequate for purposes of promoting wholesale demand response until further demand response refinements can be made in subsequent releases of MRTU.

Commission Determination

9. We appreciate the information provided on the demand response programs offered to participating customers in the California energy markets and the commitment by the CPUC to further these programs in the future. We note that no specific issues were raised by market participants regarding the CAISO tariff, and therefore, no further action is required at this time.

B. Special Case Nodal Pricing

10. SCE explains that SCNP is a voluntary program approved by the Commission for use in Independent System Operator-New England (ISO-NE) that gives eligible retail customers the option to purchase energy at a nodal price instead of an average of nodal

¹³ To be eligible, loads or aggregated loads must execute a Participating Load Agreement. The CAISO represents that the only Participating Loads in MRTU Release 1 will be pumps.

¹⁴ The CAISO states, as noted below, that SWP's pump load which is a Participating Load will be priced nodally under Release 1 of MRTU.

prices.¹⁵ SCE explains that, at the Technical Conference, representatives from SWP stated that at the time they introduced SCNP in their comments to the Commission, they did not realize that SCNP in the ISO-NE region was for eligible retail customers, not wholesale customers and that because SWP is a wholesale customer, it did not have an opinion to offer on SCNP.

11. SCE, PG&E, the CPUC and the CAISO do not support the implementation of SCNP at this time. The CPUC and PG&E noted that little interest was expressed for SCNP at the Technical Conference. SCE and the CPUC also point out that SCNP should not be considered until appropriate analysis and stakeholder discussions have been conducted. The CAISO adds that the development of SCNP in terms of software costs and implementation could negatively affect the February 2007 implementation schedule for MRTU. The CAISO states that the more prudent course would be to allow it to gain at least one year of experience with LMP before considering a program such as SCNP. NCPA also agrees that the Commission should allow the CAISO to develop information about how LMP functions in California prior to ordering the implementation of SCNP.

Commission Determination

12. Because little interest was expressed at the technical conference and market participants do not advocate the implementation of SCNP, we will not require further study of the program at this time. We expect that, in the future, market participants and the CAISO can further explore the merits of such a program.

C. Establishment of Customer-Specific LAP Zones

13. Metropolitan states that while most speakers at the technical conference expressed opposition to the creation of individual LAP zones for wholesale customers, they also spoke generally in opposition to increasing the number of LAP zones. To refute the arguments offered in opposition to individual LAP zones for wholesale customers, Metropolitan notes, among other things,¹⁶ that to the extent that a LAP is smaller, the more the LAP price and the cost of withdrawing energy at the given take-out point align. Moreover, Metropolitan states that only 0.6 percent of eligible customers within PG&E's LAP zone are eligible for nodal pricing and approximately 10 percent of wholesale load within SCE's LAP zone could elect to establish their own LAPs.

14. SWP supports an opt-out provision arguing that there is evidence to suggest that under the current proposal to charge LMP costs to loads (such as SWP's) in low cost

¹⁵ SCE notes that SCNP is scheduled to be implemented in ISO-NE in 2006.

¹⁶ Metropolitan also refutes arguments against the creation of additional geographic LAP zones, which is beyond the scope of this proceeding.

areas at a higher average LAP level, while paying those loads for demand response at the lower LMP, will thwart demand response.

15. PG&E notes that except for SWP and Metropolitan, there was little support expressed at the Technical Conference for establishment of LAP zones for specific wholesale customers. PG&E, EUF and SCE expressed concern that inequitable disparities would result from allowing some wholesale customers the ability to create their own individual LAP zone. They assert that some entities would benefit while those remaining in the LAP zone would pay a higher resulting LAP price.¹⁷ EUF and SCE argue that it is inequitable to permit wholesale customers to benefit based on the development of the grid under a prior regulatory framework where generation and transmission investments were based on trade-offs given that the vertically integrated utility operated both assets. EUF argues that allowing entities to choose to create their own LAP would turn the existing system into a means to make losers and winners of those who paid for the transmission system in the first place.

16. The CAISO states, in its rehearing request and its comments in response to the Technical Conference, that the Commission should not allow wholesale customers the option of establishing separate zones for the purposes of aggregating load. The CAISO contends that allowing participants the option to establish customer-specific LAPs, and not to participate in the broader LAP zone will likely result in significant cost impacts to consumers in transmission-constrained areas of the grid. The CAISO, the City of Santa Clara, California and Silicon Valley Power (SVP)¹⁸ and NCPA suggest that this would undermine the reason for establishing load aggregation in the first place – to blunt the potential for severe cost impacts to consumers in congested areas that exist as a result of constraints in a transmission system that was designed and constructed under an integrated utility industry structure and regulatory framework that did not anticipate locational pricing or unbundling. Accordingly, the CAISO states that requiring all market participants to participate in load aggregation will allow them to become comfortable with LMP and mitigate concerns about potential adverse impacts of nodal pricing. The CAISO states that requiring it to establish customer-specific LAP zones at this time could add significant complexity and risk to the MRTU implementation schedule. The CAISO states that the Commission should afford it and stakeholders at least one year experience with LMP before requiring it to allow for the creation of LAP zones for specific wholesale customers.

¹⁷ SCE and the City and County of San Francisco also raised these issues in their respective rehearing requests dated August 1, 2005, Docket No. ER02-1656-029.

¹⁸ See SVP Request for Rehearing, Docket No. ER02-1656-029, August 1, 2005.

17. The CPUC is likewise opposed to the establishment of specific LAPs for wholesale customers as mandated in the July 1 Order. In its request for rehearing, the CPUC¹⁹ argues that the Commission's October 28, 2003 Order²⁰ accepted the CAISO's proposed LAP zones with no provision to allow market participants to "opt-out" of the load aggregation. By mandating this option for customers, the CPUC contends that the Commission's July 1 Order reversed the October 2003 Order by allowing wholesale customers to choose to create their own LAP zone.²¹ The CPUC also states that this option is contrary to the very basis of its agreement not to oppose locational marginal prices. According to the CPUC, it has long understood since the Commission's approval in 2003 that MRTU would be implemented with three LAPs mirroring the IOUs' service territories with average LAP prices for load. The CPUC states that allowing wholesale customers to choose to create their own LAP zones at this time would result in windfalls to certain wholesale customers due to their location on the grid without any meaningful system benefits.

18. The CPUC also argues that such a provision would jeopardize the entire MRTU schedule. According to the CPUC, the priority is to get MRTU and locational marginal pricing up and running whereas this provision would provide limited benefits for a few special interests, thereby raising equity and cost-shifting issues. In addition, the CPUC argues that the absence of such a provision would not significantly impact, if at all, demand response options available to wholesale customers.²² Lastly, the CPUC asserts that requiring such a provision could have unintended consequences such as impacts on Electric Service Providers, inconsistencies between wholesale and retail rate design, inequitable cost shifting and subsidies created by historical conditions and a possible spiral of customers leaving the larger LAP zones.

19. In response to those who assert that allowing some wholesale customers to create their own LAP zones would raise the prices to load in the remaining LAP zone, Southern

¹⁹ The CPUC's rehearing request dated August 1, 2005 was a joint rehearing request with PG&E.

²⁰ *California Independent System Operator, Inc.*, 105 FERC ¶ 61,140 (2003) (October 2003 Order).

²¹ In its rehearing, CPUC/PG&E also argued that the Commission's directive for the CAISO to further disaggregate geographic LAP zones was a reversal of the October 28 Order. As noted above, this issue was addressed in the July 1 Order and the September 19 Rehearing Order.

²² The CPUC states that the establishment of a wholesale opt-out is not required to address the demand response concerns raised by State Water Project because as a Participating Load, it will pay and be paid a nodal price.

Cities argues that there has been no effort to quantify the expected impact of such a feature on the broader LAP prices.²³ Southern Cities states that the Commission should require the CAISO to analyze the projected impact of such a mechanism on prices to load remaining within the LAP zones before categorically rejecting such a proposal. In addition, Southern Cities argues that claims by the CAISO and CPUC that allowing wholesale loads to create their own LAP zones would delay implementation of the MRTU design are not credible. Southern Cities argues that if the MRTU design can accommodate nodal pricing for loads served by existing transmission contracts and SWP's pumping loads, then it should be able to accommodate LAPs for wholesale customers without delaying MRTU implementation.

20. The CAISO states that SWP and Metropolitan have provided no convincing reasons why preventing wholesale customers from creating their own LAP zones is inappropriate or imprudent as a transition mechanism for aggregating locational marginal prices for load.

Commission Determination

21. The Commission has reconsidered and will not at this time require the CAISO to provide wholesale customers the opportunity to create their own specific LAP zones. We note concerns raised by commenters and the CAISO's statements regarding risk to the MRTU implementation schedule. At this juncture, in order to preserve the CAISO's February 2007 implementation schedule, we are persuaded to allow the CAISO and market participants the opportunity to revisit this issue after a period of time using LMP and under a later release of MRTU.

D. Miscellaneous Issues

22. SWP states that the CAISO's modeling of pump loads should not determine whether large wholesale loads in a Participating Load Agreement are priced on a nodal basis. SWP argues that because the CAISO modeling practices can be subject to unilateral revision, allowing nodal pricing for participating pump load requires the establishment of objective standards. SWP states that the following objective criteria should be established in the tariff. Specifically, load that is 1) taking service under a wholesale tariff; 2) identified in a Participating Load Agreement; and 3) in the amount of at least 5 MW connected to a single node should be able to elect whether to receive nodal pricing during all operations. SCE asserts that SWP's introduction of proposed eligibility criteria for customers to select nodal pricing is premature, because the proposed criteria was not included as part of a rehearing request on the July 1 Order, and therefore, SWP is

²³ Southern Cities agrees with SWP's assertion that the amount of load represented by LSEs that may elect to leave a broader LAP zone is limited, and therefore, any adverse impact on loads remaining in the LAP zone is likely to be limited as well.

precluded from raising the issue here because its proposal constitutes an impermissible collateral attack on the July 1 Order.

23. The CAISO states that SWP's load that is served under existing transmission contracts will be priced nodally and SWP's Participating Load will be scheduled and settled at the individual nodal level rather than at the LAP level. In response to assertions that SWP's ability to receive nodal pricing as a Participating Load will be subject to modeling practices, the CAISO states that the eligibility criteria for and treatment of Participating Loads will be set forth in the MRTU tariff and no changes will be made to the eligibility criteria for Participating Loads under MRTU from that in effect currently.

24. Southern Cities raises issues regarding the ability of load-serving entities (LSEs) with internal generation resources to utilize their local resources to serve their loads without exposure to artificial congestion costs arising from adoption of broad LAP zones. In response, NCPA states that the CAISO Tariff already provides a mechanism to address the basic problem. Entities such as NCPA have the ability to form Metered Subsystems (MSS) which allows them to net their internal generation against load so that the cost differential would not arise for behind the meter generation used to serve the MSS load.

25. The CAISO argues that Southern Cities' focus on the issue of whether a large number of LAP zones will interfere with the ability of load serving entities with internal generation to obtain effective hedges against congestion costs is beyond the scope of the issues set for consideration in the Commission's Technical Conference. The CAISO states that this issue should be appropriately addressed in connection with the expected November 30, 2005 MRTU tariff filing.

Commission Determination

26. We accept CAISO's clarification regarding the pricing of SWP's Participating Load, SWP's load that is served under existing transmission contracts, and treatment of Participating Loads in the MRTU tariff. The CAISO's clarification should adequately address SWP's concern regarding its Participating Load receiving a nodal price.

27. We agree with the CAISO that the issue raised by Southern Cities regarding its ability to obtain effective hedges against congestion costs is beyond the issues set for consideration in the Commission's Technical Conference.²⁴

²⁴ We note that these issues are best addressed in the upcoming MRTU tariff filing.

The Commission orders:

Rehearing on the establishment of customer-specific LAP zones is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.