

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

California Independent System Operator
Corporation

Docket No. ER02-1656-029

ORDER ON REHEARING

(Issued September 19, 2005)

1. In this order, we address requests for rehearing and clarification of our July 1, 2005 Order,¹ in which we approved in principle the California Independent System Operator Corporation's (CAISO's) revised Market Redesign and Technology Upgrade (MRTU or Market Redesign) Proposal. Specifically, we deny in part and grant in part two of the requests for rehearing and deny other requests for rehearing, and provide clarification of the certain rulings in the July 2005 Order.

Background

2. The July 2005 Order was preceded by a series of Commission orders² approving in principle, providing guidance and seeking further information and explanation of certain aspects of the CAISO's prior market redesign proposals. The Commission issued the July 2005 Order in response to the CAISO's submission of a filing seeking approval of three amendments to its MRTU Proposal: (1) the clearing of demand bids at the load

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

² *California Independent System Operator Corp.*, 100 FERC ¶ 61,060 (2002); *California Independent System Operator Corp.*, 105 FERC ¶ 61,140 (2003) (October 2003 Order); *California Independent System Operator Corp.*, 107 FERC ¶ 61,274, *order on reh'g*, 108 FERC ¶ 61,254 (2004) (June 2004 Order).

aggregation point or LAP level; (2) a revised simplified hour-ahead market, renamed the hour-ahead scheduling process (HASP); and (3) market power mitigation measures.³

3. In the July 2005 Order, we approved in principle certain elements of the CAISO's MRTU Proposal, provided guidance, required modification of certain other elements of the proposal, and directed a compliance filing. Specifically, the Commission approved in principle the CAISO's proposal to clear bids at the LAP level; however, it found that proposed LAP zones should be further disaggregated and directed the CAISO to increase the number of currently proposed zones. We also approved in principle the CAISO's HASP proposal. The Commission reasoned that while the HASP and a full hour-ahead market have their own advantages and disadvantages, on balance, the harm from further delaying the substantial benefits of the MRTU would outweigh the net benefits gained from a full hour-ahead market. In addition, the Commission addressed the issue of whether the HASP would adequately resolve the intertie scheduling problems and directed the CAISO to file a proposed long-term solution to address intertie scheduling problems in the Amendment No. 66 proceeding.⁴ The Commission also acknowledged a concern raised with the issue of integration of the Metered Sub-System (MSS) contracts into the framework of the HASP proposal and encouraged continued discussion of this matter among the CAISO and MSS stakeholders.

4. In the July 2005 Order, the Commission also approved in principle the CAISO's market power mitigation proposal, required certain modifications and provided guidance. Specifically, in regard to the CAISO's proposed bid cap, the Commission agreed with the CAISO that the cap should be ultimately increased to \$1000/MWh; however, it directed the CAISO to make the initial bid cap a hard cap set at \$500/MWh and devised a procedure for gradually increasing the cap every twelve months, reserving the CAISO's right to make a showing that the bid cap increase is not advisable. With respect to the Residual Unit Commitment (RUC) capacity bid cap, the Commission rejected the CAISO's proposal to set it at \$100/MWh and reiterated its determination in prior orders that the RUC capacity bid cap should be set at \$250/MWh. The Commission also rejected the CAISO's proposal to apply local market power mitigation to RUC availability bids, deferring any further action until the final rules of the California Public Utilities Commission's (CPUC's) resource adequacy process are established.⁵

³ Further Amendments to the CAISO's Amended Comprehensive Market Design Proposal, Docket No. ER02-1656-026, May 13, 2005. (May 13 Filing)

⁴ Docket No. ER05-718.

⁵ See Public Utilities Commission of the State of California, Order Instituting Rulemaking To Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning, Docket # R. 04-04-003, October 28, 2004.

5. Furthermore, the July 2005 Order accepted the CAISO's proposal to eliminate system-wide Automatic Mitigation Procedures and approved in principle the CAISO's proposals for local market power mitigation measures which mirror PJM Interconnection, LLC's (PJM's) approved market power mitigation package. The July 2005 Order also addressed the CAISO's revisions to the previously proposed market power mitigation process. In particular, the Commission supported the CAISO's proposal to no longer limit the pool of units considered in the RUC process to the second pass in the Pre-Integrated Forward Market (IFM) in order to allow the CAISO to procure reliability needs from a wider range of resources without undermining the proposed local market power mitigation measures. The Commission, however, directed the CAISO to expressly state in its tariff filing the limitations of re-bidding RUC energy prices.

6. In addition, the July 2005 Order approved in principle and provided guidance on the issue of adequate compensation for frequently mitigated units (FMUs). Specifically, the Commission supported the CAISO's idea to compensate the FMUs through a bid adder and rejected the proposal to use a backstop capacity contract instead of a bid adder. The CAISO was therefore directed to continue its efforts with market participants to determine the appropriate bid adder level for FMUs. The Commission also accepted the CAISO's initial scarcity pricing proposal and required it to continue development towards a more extensive reserve shortage scarcity pricing approach with a later release of the MRTU.

7. The July 2005 Order also addressed the issue of RUC self-provision that was raised by protesters and directed the CAISO to include the RUC self-provision feature in its tariff filing in November 2005. The Commission also directed the CAISO to submit a compliance filing to provide a full explanation of the alleged infeasibility of implementing convergence bidding simultaneously with the day-ahead market, and a date when it would be feasible to implement convergence bidding.

8. The following parties filed requests for rehearing and clarification of the July 2005 Order: the CAISO; Northern California Power Agency (NCPA); the City of Santa Clara and Silicon Valley Power (collectively, SVP); CPUC and Pacific Gas and Electric Company (CPUC/PG&E); Independent Energy Producers Association (IEP); Williams Power Company, Inc. (Williams);⁶ Southern California Edison Company (SCE); Duke Energy North America, LLC, Duke Energy Trading and Marketing, LLC, and Duke Energy Marketing America, LLC (collectively, Duke); Sacramento Municipal Utility District (SMUD); the City and County of San Francisco (San Francisco). On August 16, 2005, the Metropolitan Water District of Southern California (Metropolitan) filed an answer to various requests for rehearing. Answers to rehearing requests are not permitted

⁶ Williams, in its August 1, 2005 request for rehearing, states its support for and joins the IEP's request for rehearing.

pursuant to Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d). Accordingly, we will reject Metropolitan's answer.

Discussion

LAP Level

9. CAISO, NCPA, CPUC/PG&E, San Francisco, and SVP state that the CAISO's May 13 Filing proposed a single revision to the LAP proposal, as approved in the October 2003 Order, and that the intervenors raised issues beyond the scope of the May 13 Filing, and the July 2005 Order made findings based upon an incomplete record. Specifically, they contend that because the CAISO's proposed revision in the May 13 Filing did not concern the number of LAP zones, parties were unaware that the issue was open for comment, and thus, were not given a full and fair opportunity to comment on that issue and develop a complete record. Therefore, they argue that the July 2005 Order was procedurally defective.

10. In addition, the CAISO and CPUC/PG&E state that the CAISO's July 22, 2003 filing⁷ proposed to establish three LAP areas with no allowance for opt-outs. The CAISO states that the Commission accepted this proposal, finding that it "provides a reasonable and simplified approach to introduce [locational marginal pricing], while minimizing its impact on load."⁸ Therefore, the CAISO and CPUC/PG&E argue that the July 2005 Order overturns the Commission's ruling in the October 28 Order, and does so without providing any explanation for the departure from its previous ruling.

11. The CAISO states that it does not oppose exploring the possible creation of additional LAP zones; however, CAISO and SVP submit that the Commission's requirement that the CAISO disaggregate the three LAP zones is premature. The CAISO contends that there is no substantial evidence in the record either to support a ruling that three zones is the incorrect number, or that more than three zones is appropriate. The CAISO states that it will be in a better position to present the Commission with a proposal based on additional data and feedback from market participants and LECG, Inc.

⁷ The July 22, 2003 filing was addressed in the October 2003 Order.

⁸ See October 28 Order at P 65.

(LECG),⁹ after the Congestion Revenue Rights (CRR) Study 2¹⁰ results are available, which is expected to be soon.

12. CPUC/PG&E contend that the Commission's actions were preemptory because the CAISO had committed to addressing participants' concerns with regard to load zone pricing through a future stakeholder process after the results of the CRR Study 2 were complete. They also contend that determining the appropriate number of LAP zones was not time critical because the software was flexible and could adapt to any load aggregation scheme without compromising the MRTU implementation date. They argue that the Commission should defer a decision on the issue of disaggregating load zones until after the completion of the CAISO stakeholder process and all stakeholders are given the opportunity to provide their views to the Commission for its consideration. In addition, SVP has provided a sample list of issues it intends to raise at the time the CAISO files its zonal disaggregating proposal.

13. SCE argues that LAPs with boundaries smaller than the three Investor Owned Utilities (IOUs) will require potentially costly and complex software and process modifications which jeopardize market participants' ability to meet a February 2007 implementation date. SCE therefore concludes that the Commission should reverse its determination in the July 2005 Order.

14. The CAISO and SVP assert that allowing participants to opt-out of load aggregation undermines the fundamental purpose of load aggregation and will likely result in significant cost impacts to consumers in transmission-constrained areas of the grid that have limited access to competitive supplies as a result of the structure of the California grid. SCE states that the Commission should not permit parties to opt-out of a LAP since certain parties (*e.g.*, CPUC-regulated entities) cannot choose to be billed based on their own LAP. In addition, NCPA argues that allowing loads to opt-out of LAP pricing would penalize non-IOU loads who would bear the full brunt of node-differentiated pricing. Finally, the CAISO states that requiring all market participants to participate in load aggregation will allow market participants to become comfortable with

⁹ LECG was retained by the CAISO to review and evaluate all aspects of the MRTU. LECG compiled a report entitled *Comments on the California ISO MRTU LMP Market Design* (the LECG Report), which the CAISO released to the public on February 23, 2005.

¹⁰ CRR Study 2 is designed to provide an initial estimate of the feasible sets of CRRs that eligible parties may receive through the allocation process, as well as an estimate of the financial impact of each party's allocated set of CRRs. *See* July 2005 Order at n.31. The CAISO issued the Final Report on CRR Study 2 on August 25, 2005. *See* <http://www.caiso.com/docs/2005/08/24/2005082417481216533.pdf>

the locational marginal pricing (LMP) and mitigate any concerns about the potential adverse impacts of nodal pricing.

15. The CAISO, San Francisco, and SCE argue that the opt-out option would allow market participants in low-priced nodes to establish their own zones and thereby raise the prices at the remaining nodes. SCE contends that the opt-out option allows customers with low priced local LAPs to leave the LAP (thereby driving up average prices in the residual LAP), but customers with high price individual LAPs could “free ride” by staying in the residual LAP. According to SCE, this may drive up the average prices for customers who, as a result of state legislation and policy, cannot choose to be billed based on their own LAP.

Commission Determination

16. In the July 2005 Order, we accepted zonal pricing for load and directed the CAISO to increase the number of currently proposed zones.¹¹ We disagree that the July 2005 Order addressed issues beyond the scope of the May 13 Filing. The May 13 Filing contained the LECG Report which specifically addressed the number of LAP zones and the likely consequences of using highly aggregated zones.¹² When the CAISO included the LECG Report in the May 13 Filing, that new information became part of the record, and therefore the issue of the appropriate number of LAP zones was within the scope of the proceeding.

17. In the October 2003 Order, we approved in principle the CAISO’s proposal to aggregate prices for load over the three existing service territories.¹³ However, as a result of the new information provided in the LECG Report submitted in the CAISO’s May 13 Filing, we found that it was necessary to require further disaggregation of the previously approved number of LAP zones. We disagree with the contention that the Commission reversed course from the October 2003 Order without providing a reason for its departure. We explained in paragraph 35 of the July 2005 Order that:

The Commission agrees with intervenors that the currently proposed LAP zones should be further disaggregated to provide more accurate price signals and assist participants in the hedging of congestion charges...Zonal disaggregation is supported by...the LECG Report. In its report, for example, LECG states that the “averaging of prices across the LAP eliminates significant price differences at individual nodes. This is a fundamental problem that preserves one of the principle defects of the

¹¹ See July 2005 Order at P 36.

¹² LECG Report at P 14-15.

¹³ See October 2003 Order at P 65.

previous market design that the [MRTU] was intended to eliminate.” Moreover, a “zonal bidding system is less efficient than a fully nodal bidding system.” LECG also highlighted in its report that the use of highly aggregated zones is likely to undermine the ability of the CAISO to award CRRs that effectively hedge congestion costs and may lead to unintended cost shifts among transmission customers. (*footnotes omitted*)

18. Furthermore, both the October 2003 Order and the July 2005 Order¹⁴ clearly stated that the final Commission approval of these matters would occur when the Commission accepts the detailed tariff sheet amendments and that specific issues raised by protestors will be addressed at the time of the tariff filing.

19. We agree that the CAISO should take into account the results of CRR Study 2 when re-examining its LAP zones. In the July 2005 Order we specifically stated that:

...it may be useful to have the results of the [CRR Study 2] prior to finalizing the location and size of specific zones. The Commission agrees and encourages the CAISO, in reviewing the results of its [CRR Study 2], to consider how the sizing of the zones may impede the ability of market participants to effectively hedge congestion costs due to the reduced availability of CRRs that result from larger zone definitions.¹⁵

20. We also agree that the CAISO’s stakeholder process should proceed. In the July 2005 Order, we stated that “[a]s for the appropriate number of zones to disaggregate to, the Commission turns to the CAISO and market participants.”¹⁶ Accordingly, we reiterate in this order that the CAISO is directed to re-examine its proposed LAP zones and, after taking into account the results of CRR Study 2 and its stakeholder process, disaggregate the zones further. We rely on the CAISO and market participants to complete this process expeditiously so that the CAISO can include a full proposal in its November 30 tariff filing.

21. In addition, SCE is concerned that proceeding with LAPs that are smaller than service territories of existing IOUs may require complex changes in scheduling practices and data utilized for settlements, and that implementing these changes may not be feasible by February 2007. We find SCE’s concerns to be premature at this time. As we stated above, the CAISO is directed to re-examine its proposed LAP zones, taking into account the results of CRR Study 2 and its stakeholder process. If this re-examination shows that there are efficiencies in proceeding with LAPs that are smaller than SCE’s

¹⁴ *See id.* at P 2 and July 2005 Order at P 2.

¹⁵ *See* July 2005 Order at P 37.

¹⁶ *Id.*

service territory and the CAISO makes such a proposal, then SCE may argue against and demonstrate the specific barriers to its implementing additional LAPs by February 2007. We will entertain SCE's concerns about the size of new LAP zones at the time the CAISO presents its revised LAP proposal as part of the November 2005 tariff filing.

22. In addition, we will defer discussing the opt-out provision at this time. On September 13, 2005, the Commission Staff held a technical conference to discuss issues pertaining to the special case nodal pricing, including the opt-out provision for wholesale load.¹⁷ Accordingly, the Commission will make a determination on the opt-out provisions in a future order addressing issues discussed at this technical conference.

HASP Issues

23. Duke argues that the Commission erred in rejecting implementation of a full hour-ahead market because it found that, "the harm from further delaying the substantial benefits of MRTU would outweigh the net benefits gained from a full hour-ahead market."¹⁸ According to Duke, the July 2005 Order fails to either describe or quantify the substantial benefits of the MRTU that would be lost by delaying its implementation for the few months needed to design a full hour-ahead market. For this reason, Duke requests that the Commission grant rehearing of its decision not to require implementation of a full hour-ahead market in light of Duke's belief that the net long-term benefits of an hour-ahead market clearly outweigh the costs of a possible short delay needed for its implementation.

24. Duke further asserts that if the Commission does not grant rehearing, there is a strong probability that the MRTU architecture implemented will foreclose the establishment of a full hour-ahead market altogether. Duke argues that given the already exceedingly long delay in implementing a new market design, the Commission should not resign itself to forgoing a better, more flexible market design because of a few additional months of delay. Accordingly, Duke states that the Commission should grant rehearing and either direct the CAISO to implement an hour-head market, or at a minimum, defer a final decision until after a technical conference can be convened to more fully evaluate the advantages and disadvantages of a full hour-ahead market, including software changes and the impact of potential delays in the MRTU implementation. In the alternative, if the Commission denies its request for rehearing, Duke requests that the Commission clarify that it has not foreclosed implementation of a full hour-ahead market in a future MRTU release, and further clarify that the CAISO

¹⁷ See Notice of Technical Conference, Docket No. ER02-1656-000 and ER02-1656-026, August 22, 2005.

¹⁸ See July 2005 Order at P 66.

must ensure that all further market and software design incorporate sufficient flexibility to allow for such a modification at the earliest opportunity.

25. IEP and Williams state that, although they support the implementation of the MRTU as soon as possible, they are concerned that achieving implementation of MRTU by February 2007 is controlling the Commission's determinations in this proceeding. IEP and Williams state that although the Commission identifies potential problems and issues with the CAISO's HASP, it nevertheless approves it as proposed, so as not to miss the February 2007 target implementation date for MRTU. IEP and Williams argue that rather than allowing an arbitrary target date to control its approval of HASP, the Commission should have required a definite showing that HASP is not only just and reasonable, but is superior to the full hour-ahead market design. IEP and Williams state that the Commission should not settle on incomplete or inferior proposals in order to achieve the CAISO's latest target implementation date.¹⁹

26. IEP and Williams state that a full hour-ahead market would allow for substitution across Scheduling Coordinators either through trades or through participation in the CAISO's market, and it would also permit substitution across multiple resources that are otherwise considered by the CAISO to equally qualify to provide services. IEP and Williams believe that the lack of a full hour-ahead settlement for ancillary services raises fundamental concerns about the transparency of the settlement for post day-ahead ancillary services and the ability for the bilateral market to function given the proposed limited functionality. Moreover, IEP and Williams assert that the HASP proposal: fails to provide a capacity payment for hour-ahead and real-time ancillary services providers; fails to detail how the CAISO will set and apply a market clearing price for ancillary services; and, fails to clearly identify whether the highest opportunity cost will set the clearing price for all units or whether the clearing price will be set by some other means.

27. The CAISO requests that the Commission clarify that its solution to the problem of settling intertie bids proposed in its Amendment No. 66 may be temporary and that a more permanent solution to this issue will be developed through the MRTU stakeholder process and implemented as part of HASP in February 2007. The CAISO states that in the July 2005 Order, the Commission noted that it had directed the CAISO to file a proposed long-term solution to address intertie scheduling problems identified in Amendment No. 66. The CAISO requests clarification that the Commission did not intend that the CAISO would necessarily continue to use that solution when HASP is implemented as part of MRTU Release 1 in February 2007. The CAISO states that it plans to explore with its stakeholders the issue of which intertie settlement solution will be the best option under HASP, the current "as bid" methodology or an alternative

¹⁹ According to IEP and Williams, this approval is a piecemeal repair the Commission has sought to avoid.

methodology to be implemented with the new software, and to file the preferred solution as part of its MRTU Tariff filing in November 2005.

Commission Determination

28. We deny Duke, IEP and Williams' requests for rehearing.²⁰ We disagree that our decision not to require implementation of a full hour-ahead market was driven exclusively by the CAISO's February 2007 implementation date for MRTU. Our July 2005 Order recognized the advantages and disadvantages to adopting either the full hour-ahead market or the HASP proposal and, concluded that, on balance, approval of the HASP was the prudent course to take at this time.

29. We grant Duke's request for clarification, however, and clarify that we have not foreclosed implementation of a full hour-ahead market in the future.²¹ Specifically, in the July 2005 Order, we stated that:

we approve[d]] the proposed HASP, but encourage[d] the CAISO to work closely with its stakeholders in determining whether an hour-ahead market is the appropriate solution to the issues raised in Amendment No. 66, and whether the CAISO should work to incorporate it in its initial release of MRTU.²²

30. We also clarify that the CAISO must ensure that its market design software incorporates sufficient flexibility to allow for future modifications. In deciding to approve the HASP at this time, the Commission relied on the broad support expressed by the California Electricity Oversight Board, the CPUC, SCE, PG&E, SVP, and Metropolitan,²³ as well as by the market consultants retained by the CAISO,²⁴ who argued that the benefits associated with a full hour-ahead market do not justify the

²⁰ Issues raised by IEP were answered in the July 2005 Order at P 60, 71-73.

²¹ *See id.* at P 80.

²² *See id.*

²³ *See id.* at P 49-52.

²⁴ *See* Attachment D to the CAISO's May 13 Filing, Comments of Harvey and Hogan on the CAISO's Proposed Hour-Ahead Scheduling Process, at 2. "[T]here are not likely to be material incremental benefits from introducing an additional hour-ahead settlement process in conjunction with the initial implementation of the MRTU market design. There would be material incremental costs and implementation risks. Hence, the cost-benefit tradeoff indicates that the benefits would not justify the costs."

implementation costs for this market in Release 1.²⁵ In addition, our decision to approve the HASP is based on the representation by the CAISO that implementation of an hour-ahead market at a future date, after the initial implementation of MRTU, would not be prohibitively difficult or costly given the flexibility being incorporated into the new settlements system.²⁶ We rely on these representations by the CAISO and clarify our expectation that the structure of the CAISO's market software should not preclude future changes in the system architecture, including the establishment of a full hour-ahead market.

31. In the discussion of the HASP in the July 2005 Order, the Commission noted that several parties had filed comments regarding whether the HASP would adequately address the intertie scheduling problems that led to the CAISO's filing of Amendment No. 66 in Docket No. ER05-718 on March 23, 2005. The Commission also stated that the CAISO was considering various options as part of a stakeholder process in that proceeding and would be filing its proposed long-term solution to address the intertie scheduling problems in that docket.²⁷

32. In the Docket No. ER05-718 proceeding, the Commission directed the CAISO to propose a long-term solution to the issues it raised in its Amendment No. 66 filing.²⁸ Instead, on July 26, 2005, the CAISO submitted a proposal to maintain the "as bid" settlement rule for settling intertie import and export bids as an interim solution to remain in effect until the implementation of MRTU. The CAISO states that it is currently conducting a stakeholder process to determine the best long term methodology for settling intertie bids under the HASP and the CAISO commits to filing the long-term solution as part of its MRTU tariff filing in November 2005.²⁹ In its rehearing request, the CAISO seeks assurance that the Commission did not intend that its proposed interim solution filed in Docket No. ER05-718-003 on July 26, 2005 to address intertie scheduling problems was to be used upon implementation of MRTU in February 2007.

33. The CAISO's proposal to implement an interim solution in Docket No. ER05-718-003 is currently pending before the Commission and we will not prejudge our

²⁵ Release 1 includes design features and elements that by necessity will be included in the MRTU implementation in February 2007.

²⁶ See the CAISO's May 13 Filing at 30.

²⁷ See July 2005 at 69-70.

²⁸ *California Independent System Operator Corporation*, 111 FERC ¶ 61,008 (2005).

²⁹ See the CAISO's Request for Extension of Tariff Authority for "As-Bid" Settlement of Pre-Dispatched Intertie Transactions, Docket No. ER05-718-003, July 26, 2005, Transmittal Sheet at 12.

determination on that proposal. We clarify that our reference in the July 2005 Order to the “long-term solution” for the intertie scheduling problems does not require the CAISO to implement its proposed “interim solution” submitted on July 26, 2005 in Docket No. ER05-718, as part of MRTU Release 1 in February 2007. We note that the CAISO should consider all options for a long-term solution to address the intertie scheduling problems and should ensure that any long-term solution is compatible with the implementation of future releases of MRTU.

Market Power Mitigation

Bid Cap

34. The CAISO proposed, in its May 13 Filing, to initially utilize a \$250/MWh soft cap and gradually move to a final hard cap of \$1000/MWh. The CAISO proposed that the increase would be based upon its annual evaluation of the competitiveness of the market beginning sixteen months after the MRTU implementation and would be subject to the condition that the market design was functioning as planned and that the market could sustain the increase. However, in the July 2005 Order, the Commission required the CAISO to adopt a \$500 hard cap that would increase to \$750/MWh one year later and finally \$1000/MWh two years after implementation.

35. CPUC/PG&E contend that the Commission’s determination in the July 2005 Order to raise the energy bid caps is not based upon the record before it, improperly binds future Commissions, improperly delegates responsibilities, and disregards Commission precedent. Specifically, CPUC/PG&E argue that: (1) it is not within the power of the Commission to predetermine what the Commission sitting at the time that the submissions are made should decide, and the July 2005 Order requiring automatic increases would do just that; (2) the Commission’s determination to apply a bid cap modeled after an eastern market bid cap ignores the fact that the California market is different from the eastern markets, and the Commission has not provided justification that demonstrates that the eastern bid caps are appropriate in the California market nor has it been shown that the market conditions warrant utilizing such bid caps; and (3) the Commission did not articulate its rationale for adopting the July 2005 Order bid caps, and therefore, the decision is arbitrary.

36. Furthermore, CPUC/PG&E and San Francisco contend that: (1) nothing in the record has provided, or could provide, the Commission with the factual basis to determine if the market will be competitive enough in approximately 2.5 years from the July 2005 Order (approximately 2 years from MRTU implementation date) to warrant the bid cap increase; and (2) the nature of the automatic bid cap increases assumes that the rate will be just and reasonable, thereby delegating the Commission’s responsibilities to the CAISO or other entities by requiring them to submit a filing showing otherwise. San

Francisco requests that the Commission grant rehearing on this issue because it permits an automatic bid adjustment without an *ex ante* assessment of the CAISO's market.

37. IEP and Williams argue that the \$500/MWh energy bid cap fails to take into account the change in CAISO market conditions. IEP and Williams state that in order to ensure that buyers have sufficient incentive to enter into long-term contracts, the energy bid cap should be raised to \$1,000/MWh as of the implementation date of the MRTU. Additionally, IEP and Williams contend that raising the bid cap will stimulate demand response, new investment, and load participation.

Commission Determination

38. The CAISO proposed a bid cap level of \$1000/MWh, but requested an initial level of \$250/MWh with a phase-in period of three years to allow the market participants to adjust to the new market rules. The Commission agreed with the ultimate level and with the phase-in approach, but determined in the July 2005 Order that the initial level should be set at \$500/MWh to avoid the potential problems identified by the CAISO in its May 13 Filing, *e.g.*, gas prices throughout the west may rise such that energy bids above \$250/MWh may be cost-justified.

39. We believe 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. As the Commission stated, bid caps are meant to serve as circuit breakers to supplement, if necessary, properly constructed mitigation.³⁰ While reviewing the CAISO's MRTU proposal, we found that there is significant support for the increased bid caps. A low bid cap could adversely impact reliability, by artificially suppressing resource prices when they are scarce, rather than only when market power is exercised. We found that \$1000 is an appropriate bid cap level for the CAISO, but also recognized that that level should be reached in incremental steps to allow market participants time to adjust to the new caps and other mitigation procedures while still ensuring competitive markets. For these reasons, we find no merit to the CPUC/PG&E's argument that the Commission is trying to predetermine whether market conditions in the future would allow for a bid cap increase. We reiterate here that if, at any time, the CAISO believes that the mitigation package in combination with strong market behavior rules and the must-offer obligation for resource adequacy resources is insufficient to prevent the exercise of market power, it should immediately request a change of one or more of the market power mitigation measures, including the level of the bid cap. For these reasons, we deny rehearing on this matter.

³⁰ See July 2005 Order at P 104.

Residual Unit Commitment

Frequency of Non-Resource Adequacy Units Committed in RUC

40. The CAISO contends that the Commission should reverse its decision to eliminate local market power mitigation measures for RUC availability bids. The CAISO states that it anticipates that much of its forward load forecasts will be met through capacity provided under resource adequacy capacity contracts or Reliability Must-Run (RMR) contracts; however, there will be situations when it needs to procure RUC capacity from resources that are not subject to such contracts. The CAISO contends that such situations can arise due to resource adequacy units within a particular region being forced out of service, transmission de-rates, or unusually high loads. Further, the CAISO contends, while a load serving entity's (LSE's) exposure to RUC availability costs can be limited by fully scheduling all of its forecasted load in the IFM, it is often not cost effective for an LSE to do so, particularly if there are opportunities to procure from lower cost supply sources that are not available until the hour-ahead time frame.

41. SCE also believes that the Commission erred in assuming that RUC would be an infrequently used backstop mechanism. SCE states that the CAISO has indicated that RUC will be used to procure generation for local reliability needs as well as for meeting system reliability needs. SCE contends that MRTU stakeholder discussions and CPUC resource adequacy workshops indicate that it is not expected that LSEs with a resource adequacy requirement will be able to procure sufficient local generation to address all of the CAISO's local reliability needs.

RUC Market Power

42. On rehearing, the CAISO contends that the lack of effective local market power mitigation for RUC availability bids may allow resources with local market power to force LSEs seeking to fulfill their resource adequacy requirements into local capacity contracts at higher prices than could be justified in truly competitive markets. The CAISO disagrees with the Commission's statement that the proposed mitigation of RUC availability bids will be "complicated and intrusive." The CAISO states that it is simple – if a resource has its energy bid mitigated for local market power, its RUC availability bid will also be mitigated.

43. CPUC/PG&E assert that the Commission's decision to reject the CAISO's proposal with respect to RUC is an abuse of discretion because the decision was based on conjecture rather than facts. CPUC/PG&E contend that while the Commission suggested that the likely magnitude of RUC availability costs would not warrant the added complexity of local market power mitigation for such costs, it did not identify any evidence from a cost benefit analysis supporting that conclusion.

44. SCE adds that prior to allowing market-based rate authority for RUC availability bids, the Commission must either find that sellers lack market power and that the markets are not subject to manipulation, or provide local market power mitigation for RUC availability bids. SCE maintains that the Commission cannot reject local market power mitigation for RUC without empirical proof that existing competition would ensure that resulting prices would be just and reasonable.

RUC Payment

45. The CAISO requests that the Commission clarify that the July 2005 Order does not preclude the CAISO from including in its MRTU tariff provisions protections to ensure that resources being compensated for satisfying resource adequacy requirements will not be eligible to receive RUC availability payments. If the July 2005 Order did intend to preclude the CAISO from including such protections, the CAISO argues that the Commission erred because: (1) procedurally, it would be premature for the Commission to rule on this issue prior to completion of the stakeholder process and presentation of a full record to the Commission; and (2) failure to prevent RUC availability payments to Resource Adequacy (RA) units under the CAISO tariff would introduce tremendous complexity in the resource adequacy program being developed by the CPUC.

46. The CAISO further requests that the Commission clarify that it did not intend to presume or constrain the outcome of the ongoing stakeholder process and that it will consider the CAISO's proposal in the context of the November 2005 MRTU tariff filing. If the Commission did have such an intention, then the CAISO argues that double payment (RUC availability and RA capacity payments) to resources for providing a single service should be prevented by CAISO tariff sections governing RUC availability payments to provide that units receiving payment for RA capacity will not be eligible to receive RUC availability payments. The CAISO states that RA contracts could be designed to require unit owners to credit any RUC availability payments they receive back to the LSE paying for the RA capacity, but such a credit-back mechanism would be inefficient and complex. To the extent that the July 2005 Order constitutes a directive that such protections against double payment should be included in the CPUC resource adequacy requirements and should not be included in the CAISO's November 2005 MRTU tariff filing, the CAISO requests that the Commission reverse this aspect of the July 2005 Order.

47. SCE requests that the Commission direct the CAISO to include tariff language that requires RA resources to be treated as price takers for RUC availability. If the zero-dollar bid rule is contained only in resource adequacy contracts, but not as a market rule in the CAISO tariff, SCE asks how parties will verify that the resource adequacy seller actually bids zero. SCE also questions what recourse the Commission envisions if the RA seller submits a non-zero bid contrary to contract requirements. Additionally, SCE

seeks clarification that the CAISO can continue with its current proposal to not pay RA resources an availability payment.

RUC Self-Provision

48. The CAISO requests that the Commission clarify that it is not required to include RUC self-provision in its November 2005 MRTU tariff filing if the CAISO concludes, based on stakeholder input, that the provision should not be included in MRTU Release 1. The CAISO states that the June 2004 Order suggests that RUC self-provision is a market feature that has been developed primarily in response to stakeholder requests and has not been identified by either the Commission or the CAISO as an essential feature of the MRTU market design.

49. The CAISO notes that the July 2005 Order states that the Commission “expect(s) the CAISO to include the RUC self-provision feature in its tariff filing in November 2005.”³¹ However, the CAISO contends that based on recent stakeholder input it is apparent that most if not all stakeholders do not believe that the RUC self-provision feature is needed as part of MRTU Release 1. Thus, the CAISO requests clarification that it has the flexibility to elect not to include RUC self-provision in the November 2005 MRTU tariff filing if it concludes this feature should not be included in MRTU Release 1.

Commission Determination

50. We clarify that the July 2005 Order did not preclude the CAISO from proposing tariff provisions concerning the eligibility of a must-offer resource to receive RUC availability payments. The CAISO also requests that the Commission clarify that the CAISO is not required to include RUC self-provision in its November 2005 MRTU tariff filing. We clarify so. However, we expect that the CAISO will address reasons for the inclusion or exclusion of RUC self-provision in a transmittal letter to its tariff filing in November 2005.

51. Our decisions in the July 2005 Order was based on the assumption that California’s resource adequacy plan would be developed in a manner that plans for forced outages, transmission de-rates, or unusually high loads. We also assumed that California’s resource adequacy plan would be sufficient to ensure that available resources are lined up to cover the CAISO’s capacity needs even if LSEs under-schedule in the day-ahead in anticipation of less expensive resources available closer to real-time operation. The Commission also based its decision on the expectation that California’s resource adequacy plan will provide the CAISO with sufficient available resources and

³¹ See *id.* at P 181.

capacity to maintain grid reliability. If the State's resource adequacy requirements fail to do so, applicable MRTU issues will be readdressed as appropriate to ensure just and reasonable rates.

52. Furthermore, it is premature to address the potential exercise of market power in resource adequacy contracts at this time when final rules and requirements have not been determined. The Commission will take appropriate action to ensure that the CAISO market rules result in just and reasonable rates.

53. We agree that payments for RUC capacity and for resource adequacy capacity might be considered two different payment mechanisms for the same service. However, as the terms and obligations of California's resource adequacy plan are not final, it would be premature to explicitly conclude that it would not be appropriate for payments to flow through to the resource adequacy supplier. The Commission reiterates that its decisions are not intended to prevent revenues from RUC availability payments from flowing back to LSEs. As the State is taking the lead role in the resource adequacy process, the best mechanism to avoid a potential for double payment is through clear resource adequacy guidelines in California's resource adequacy rules and requirements. Such rules or resource adequacy contracts could require RA suppliers to forfeit or transfer revenues associated with RUC procurement. Nothing in the July 2005 Order precludes the CAISO from directing such RUC availability payments in a manner consistent with California's resource adequacy plan. We also note that other ISOs have structured and coordinated their resource adequacy programs to avoid the need for RUC payments altogether; thus RUC bids are by no means a prerequisite for just and reasonable rates and reliable grid operation.

54. For these reasons, we deny rehearing that RUC availability bids require mitigation at this time and clarify that the July 2005 Order does not preclude the CAISO from proposing tariff language that will make State resource adequacy units ineligible to receive RUC availability payments, to the extent that such provisions are consistent with the resource adequacy agreements entered into by the RA supplier.

55. In response to SCE's concerns regarding coordination of California's resource adequacy program and the CAISO's efforts, it is premature to speculate on the Commission's role in enforcing the provisions of California's resource adequacy plan until the process is complete and the resource adequacy rules and requirements have been clearly defined.

Comparison to PJM Market Design

56. IEP and Williams state that while the CAISO proposed to allow for three options of mitigated bids like PJM, the Commission cannot, on that basis alone, conclude that the

CAISO has “mirrored PJM’s approved market design package.”³² IEP and Williams argue that the PJM’s full market design includes at least three critical features that have not yet been replicated in the CAISO’s proposed markets; these are a \$1,000/MWh bid cap for energy, a capacity market, and compensation for reliability resources, including resources that may seek to retire.

57. IEP and Williams further contend that the CPUC resource adequacy requirements are slated to take effect in June 2006, but for 16,640 MW of market generation presumed by the CAISO to have local market power – the amount the CAISO has recently identified as needed for local area requirements – the only capacity compensation available may be a yet undefined, and almost certainly cost-based, not market-based, “backstop” contract with the CAISO. Furthermore, IEP and Williams argue that the CAISO’s existing RMR tariff provisions, and *pro forma* RMR contract, will remain a key component of the MRTU proposal without any mention or consideration of rates, terms, and conditions necessary to deactivate reliability resources that cannot recover their costs in the CAISO’s markets.

58. IEP and Williams state that while the CAISO is advancing the use of a bid adder for FMUs, its own data indicate that no non-RMR units would meet the criteria that a unit must be mitigated in 80 percent of its run hours to qualify for such an adder. IEP and Williams also assert that bid adders – which provide a contribution to fixed costs only when a unit operates – cannot provide adequate compensation for units that are needed for reliability but do not run frequently. Additionally, IEP and Williams state that the CAISO’s proposal does not demonstrate how a pricing system that drives prices to short run marginal cost and excludes scarcity value is just and reasonable.

59. Finally, IEP and Williams argue that given all these things, the Commission cannot reasonably conclude that the CAISO has “mirrored” the PJM market design so as to warrant the implementation of PJM-style local market power mitigation.

Commission Determination

60. In the July 2005 Order, the challenged statement that the CAISO has mirrored PJM’s approved market power mitigation package was meant to convey the idea that the CAISO had submitted a local market power mitigation package that was similar to that approved in PJM. The Commission did not intend to imply that the CAISO’s complete market design mirrored PJM, only that the local market power mitigation package mirrors that of PJM, which has previously been approved and is operational. We approved the CAISO’s proposed local market power mitigation package based on its ability to mitigate market power abuses while understanding that the final resource

³² See *id.* at P 122.

adequacy requirement rules are still being developed, but with the expectation that the requirements will satisfy the goals as stated by the CAISO. We will evaluate the CAISO's November 2005 MRTU tariff filing as a package, based on the concepts discussed in the July 2005 Order. For this reason, we deny IEP and William's rehearing requests.

Calculation of Bid Adders

61. The CAISO requests that the Commission clarify that the CAISO is not required to calculate the incremental costs of using bid adders for FMUs in calculating LMPs or to allocate these costs to LSEs based on their share of under-procured capacity. The CAISO states that, consistent with the PJM approach, it would allow bid adders to be applied to a unit's default energy bid and to set LMPs. As a result, the CAISO notes, the costs of bid adders arise directly from the settlement of LMPs. The CAISO argues that there is no reason to treat it differently than PJM on this issue and the Commission has not enunciated any reasons for doing so.

62. Furthermore, the CAISO submits that it would be unjust and unreasonable to allocate the costs of bid adders imposed on LSEs based on their share of under-procured capacity, and requests that the Commission clarify that it will not be required to do so. The CAISO notes that it could potentially address the Commission's underlying goal of allocating capacity costs based on responsibility for incurring those costs in the context of local capacity contracts.

Commission Determination

63. In the July 2005 Order, the Commission merely noted that the CAISO intended to develop a bid adder for FMUs and did not impose any requirements on the methods used to calculate the amount of the bid adder.³³ The Commission clarifies that it has only approved the concept of a bid adder, not the calculation or quantification of the bid adder, because that has not yet been proposed.

Process for Mitigating Units

64. IEP and Williams state that under the CAISO's proposed approach, all bids dispatched from a given unit in Pass 2 of the Pre-IFM Process are deemed non-competitive if any bid dispatched from that unit is mitigated. IEP and Williams believe that such a process completely ignores whether a unit's range of bids legitimately responds to scarcity conditions or is the result of the exercise of market power.

³³ *Id.* at P 146.

65. IEP and Williams state that the CAISO proposal to mitigate a unit's entire remaining bid string if the unit is dispatched to address any non-competitive constraint is conducted using the CAISO's load forecast. However, IEP and Williams point out that the final IFM market run that establishes day-ahead prices will be conducted using bid-in load, not the CAISO's load forecast used in Pass 2. Thus, IEP and Williams conclude that load-serving entities will not only be afforded local market power mitigation for load that they may not have even bid into the day-ahead market, but for every remaining MW of the unit's operating range, regardless of the reason for which the unit might be subsequently dispatched.

66. IEP and Williams state that while subjecting the entire remaining bid to local market power mitigation is severe, it is even more severe to apply all-encompassing mitigation based on the CAISO's load forecast, not the bid-in load. IEP and Williams contend that it is rational and equitable that LSEs that want the protection of local market power mitigation in and beyond the day-ahead market should bid all of their load into the day-ahead market.

67. Furthermore, IEP and Williams argue that the CAISO has cherry-picked those elements from PJM that provide the most mitigation (such as local market power mitigation) while choosing not to pursue those elements from PJM that provide for the greatest opportunity for competition and reasonable compensation. In addition, IEP and Williams seek clarification with respect to the following Commission findings, as stated in Paragraph 163 of the July 2005 Order:

In the June 2004 Order, the Commission determined that units should be allowed to re-bid or adjust their day-ahead IFM market bids if they were not taken in that market, but subsequently selected for day-ahead RUC. Thus, the CAISO upon making its tariff filing should expressly note the limitations of re-bidding day-ahead RUC energy prices.

68. IEP and Williams state that the referenced portion of Paragraph 163 seems to hold out the expectation that a unit not dispatched in the IFM, but then selected for RUC, could re-bid its energy price. IEP requests that the Commission clarify its position with respect to units mitigated in Pass 2.

Commission Determination

69. We agree with IEP and Williams that market power mitigation should only be applied based on bid-in load, not the CAISO's forecasted load. The market power mitigation measures approved are intended to protect day-ahead purchasers from market power. In addition, real-time purchases will also be subject to Commission-approved market power mitigation. There is little justification for the additional mitigation of

supply bids for energy based on the CAISO demand forecasts rather than the demand by market participants in the day-ahead market. Rehearing is hereby granted on this issue. We also clarify that a unit not dispatched in the IFM, but then selected for RUC, can re-bid its energy price. However, we note that such energy bids will remain subject to real-time mitigation procedures.

Scarcity Pricing

70. IEP and Williams disagree with the Commission's findings in the July 2005 Order that the CAISO's proposal has some forms of reserve shortage scarcity pricing for the real-time and day-ahead markets, which will give appropriate price signals during periods of scarcity and provide the necessary incentives for contracting and investment. IEP and Williams state that first, the CAISO proposes to trigger scarcity pricing for real-time ancillary services at a point well after such scarcity may actually occur, and second, it is not clear under what circumstances the CAISO intends to apply scarcity pricing in the day-ahead market, so it is not clear whether such pricing will provide the appropriate responses.

71. IEP and Williams also contend that the first type of scarcity pricing that the CAISO asserts is imbedded in its proposed MRTU is a mechanism that would set the price of reserves to the price cap in real time if the CAISO was forced to deploy contingency-only reserves after all supplemental energy bids were exhausted. IEP and Williams assert that scarcity pricing for real-time ancillary services should be triggered when the CAISO's real-time reserves, including contingency-only reserves, drop below the Western Electricity Coordinating Council-mandated requirements, not just when it has exhausted its supplemental energy bid stack. IEP and Williams caution that absent this approach, the CAISO may be tempted to view its supplemental energy bid stack as a source of real-time reserves without designating such unused and available capacity as ancillary services capacity.

72. IEP and Williams state that the second type of scarcity pricing mechanism that the CAISO asserts is contained in its MRTU proposal would set the day-ahead energy price to the bid cap at a node where self-scheduled load has been uneconomically curtailed in the day-ahead market. IEP and Williams assert that the proposal does not elaborate whether the self-scheduled load was curtailed at a particular node due to transmission constraints, or curtailed across many nodes due to an overall supply shortage.

73. IEP and Williams further state that it is unclear whether the CAISO's proposal to value load at the bid price cap in the "forward markets" would take place before or after the day-ahead RUC process. Presumably, IEP and Williams argue that the CAISO could commit additional capacity that could remedy either a local constraint or system-wide shortfall in the RUC process and obviate the need to trigger scarcity pricing. IEP and Williams contend that if it could not, then scarcity pricing is appropriately applied.

Commission Determination

74. In the July 2005 Order, the Commission noted that the CAISO has some aspects of scarcity pricing, which we found acceptable at this time, though not necessarily sufficient in the long run. We interpret the CAISO's scarcity pricing proposal as being triggered in real time whenever the total available generation capacity is insufficient to meet load and its ancillary service requirements. IEP and Williams seem to be concerned that the CAISO may fail to designate and pay for enough capacity to meet its full ancillary service requirements at times when there is enough spare capacity from its supplemental bid stack to do so. We clarify that the CAISO in its real-time operational reserve procurement must **designate and** pay the applicable real-time ancillary service price to all resources that CAISO relies on in real-time for ancillary services. Additionally, we expect that the scarcity pricing mechanism outlined by the CAISO for self-scheduled load will be triggered both when load is curtailed at a particular node due to transmission constraints and when load is curtailed across many nodes due to an overall supply shortage. We also expect that if the RUC process cannot remedy either a local constraint or system-wide shortfall in the forward market, then scarcity pricing will be applied. As stated in the July 2005 Order, we require the CAISO to continue development towards a more extensive reserve shortage scarcity pricing approach to be incorporated in a later MRTU release.³⁴

Capacity Market

75. IEP and Williams state that the CAISO's local market power mitigation proposal includes a provision under which the CAISO would continue to serve as the reliability backstop and assert that the proposal envisions that the CAISO will execute "reliability backstop contracts" with specific generators in order to serve the role. IEP and Williams believe that the July 2005 Order did not address this important matter, leaving unclear whether the Commission approves of this aspect of the CAISO's proposal. Moreover, IEP and Williams contend that the Commission failed to address IEP's proposal to establish a capacity market/interim capacity payment mechanism to allow for a market-driven reliability backstop.

Commission Determination

76. As stated in the July 2005 Order,³⁵ the Commission believes it would be more productive for the CAISO to focus on market solutions, rather than ISO-administered backstop contracts, which the CAISO was exploring. In the July 2005 Order, the

³⁴ July 2005 Order at P 152-153

³⁵ July 2005 Order at P 145.

Commission encouraged the CAISO to focus its efforts on market solutions that rely on forward contracting by LSEs, rather than ISO-administered backstops. We acknowledge IEP's proposal to develop a capacity market or interim capacity payment mechanism to allow for a market-driven reliability backstop and encourage it to propose such an idea by actively engaging in the CAISO's stakeholder process so that that it might be proposed by the CAISO in the future, at which time we will act on it. At this time, we expect that forthcoming resource adequacy procedures and mitigation package will ensure just and reasonable rates.

Miscellaneous Issues

SMUD's Rehearing Request

77. On rehearing, SMUD argues the Commission had no authority under section 205 of the FPA³⁶ to approve in principle a filing on concepts. According to SMUD, the Commission disregarded SMUD's showing that it would be impossible to resolve through the stakeholder process such a lengthy list of issues prior to making a tariff filing in November 2005. SMUD also contends that the ultimate resolution of the pending issues will result in costly changes to software. SMUD further argues that the Commission misconstrued SMUD's opposition to the filing as an objection to the arbitrary nature of the February 2007 implementation target date, while SMUD argued that the February 2007 deadline is infeasible. SMUD further states that the Commission erred in failing to establish an evidentiary hearing to explore the issue of whether further developments would necessitate expansive changes to the software.

Commission Determination

78. We deny SMUD's request for rehearing. We reiterate in this order that in the July 2005 Order, we acted on a filing on concepts, not an FPA section 205 filing, and that our approval of the filing was in principle only. Our objective was only to provide guidance, as requested by the CAISO, on whether the proposed market design elements were acceptable, so that the CAISO could proceed with development of software and systems, and the preparation of detailed tariff sheet amendments. The matters discussed in the CAISO's May 13 Filing and the July 2005 Order and this order are subject to further proceeding.

79. We also reiterate that SMUD's contentions that the CAISO's stakeholder process might not result in resolution of the pending issues in time for the November tariff filing is not a compelling reason for rejecting the CAISO's May 13 Filing. The CAISO informed us that it planned to conduct a several-month stakeholder process to address

³⁶ 16 U.S.C. § 824d (2004).

pending matters. At present, it is premature to draw any conclusions on the possible success of that stakeholder process. It would also be premature to establish an evidentiary hearing to explore whether the ultimate resolution of the pending issues will result in costly changes to software. The CAISO plans to make a tariff filing in November 2005. Only at that time will the Commission be able to determine whether the pending issues have been resolved among the CAISO and stakeholders. Accordingly, SMUD's request for an evidentiary hearing is hereby denied.

80. Contrary to SMUD's contention, we do not find the February 2007 implementation target date to be infeasible. This target date was first suggested by the CAISO on the basis of its Board of Governors' decision to extend the previously established deadline until February 2007 due to the complexity of the task and the need for significant coordination in assuring that all components would operate seamlessly.³⁷ The information submitted by the CAISO in its subsequent status reports has assured the Commission that the CAISO can remain on track for the February 2007 implementation target date.

Metered Sub-Systems

81. SVP states that the Commission, in its June 17 Order, accepted the CAISO's HASP proposal, and, with regard to the treatment of MSS contracts, the Commission stated that "we anticipate that this and related issues will be resolved through the current stakeholder process addressing all issues related to existing MSS contracts."³⁸ On rehearing, SVP requests that the Commission reiterate that the purpose of the CAISO's MSS stakeholder process with respect to the HASP is to develop mechanisms by which MSS agreements can be honored in conjunction with the HASP. Despite the Commission's encouragement of continued discussions between the CAISO and MSS entities, NCPA remains concerned that more work needs to be done to address the means by which existing metered sub-system entities such as NCPA's members will be integrated into the MRTU market design, including resource adequacy requirements. NCPA requests the Commission direct the CAISO to commence further discussions within the next two months.

Commission Determination

82. We reiterate in this order that we encourage continued discussion on the issue of integration of MSS agreements within the MRTU framework among the CAISO and MSS stakeholders.

³⁷ The CAISO's Monthly Status Report, Docket No. ER02-1656-011, at 5 (July 6, 2004).

³⁸ June 2004 Order at P 94.

Convergence Bidding

83. In the July 2005 Order, we directed the CAISO to file, within 30 days of the date of issuance of this order, a full explanation of the alleged infeasibility to implement convergence bidding simultaneously with the day-ahead market. In that filing, the CAISO was also directed to provide a date when it would be feasible to implement convergence bidding.

84. IEP and Williams challenge our finding on convergence bidding on rehearing. Specifically, IEP and Williams note that in IEP's protest³⁹ to the CAISO's May 13 Filing, IEP argued that the absence of convergence bidding promotes LSEs' systematic and successful exercise of market power during periods of high demand for electricity during which LSEs can understate load to achieve a lower day-ahead price while making shortfalls in the real-time market. Additionally, IEP and Williams argue that convergence bidding has co-existed with LMP-based energy markets and transmission rights for years, and implementation in California merely requires translation of these established methods. IEP and Williams believe that the Commission should require the implementation of convergence bidding simultaneous with Release 1 unless the CAISO clearly and conclusively demonstrates that such implementation is not possible, irrespective of whether such implementation delays the roll-out of Release 1.

85. IEP and Williams note that the July 2005 Order directed the CAISO to file "a full explanation of the alleged infeasibility to implement convergence bidding simultaneously with the day-ahead market."⁴⁰ However, IEP and Williams believe that given the statements contained in the July 2005 Order, it would seem that all the CAISO needs do in order to be excused from implementing convergence bidding simultaneously with the day-ahead market is to argue that such implementation will delay Release 1 beyond February 2007. IEP and Williams believe this excuse is clearly insufficient.

Commission Determination

86. On August 8, 2005, the CAISO submitted a compliance filing, as directed by the July 2005 Order, which is currently pending before the Commission in Docket No. ER02-1656-030. Because on rehearing of the July 2005 Order, IEP and Williams raise issues similar to the argument they made in their protests to the CAISO's compliance filing, we will address IEP and Williams' concerns in an order on the CAISO's compliance filing.

³⁹ IEP's June 8, 2005 protest was a joint protest with the Western Power Trading Forum.

⁴⁰ See July 2005 Order at P 174.

The Commission orders:

(A) Rehearing requests by Duke, NCPA, SVP, San Francisco, SMUD, and SCE are hereby denied, as discussed in the body of this order.

(B) Rehearing requests by IEP and Williams are hereby granted in part and denied in part, as discussed in the body of this order.

(C) Clarification of the July 2005 Order is hereby provided, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.