20080728-3036 FERC PDF (Unofficial) 07/28/2008

124 FERC ¶ 61,094
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

California Independent System Operator Corporation   Docket Nos. ER07-869-002
ER07-475-003
ER06-615-010

ORDER DENYING REQUESTS FOR REHEARING AND CLARIFICATION

(Issued July 28, 2008)

1. In this order, the Commission responds to requests for clarification and/or rehearing of an order it issued on July 6, 2007 that conditionally accepted, subject to modification, proposed revisions to the California Independent System Operator Corporation's (CAISO) Market Redesign and Technology Upgrade (MRTU) Tariff concerning short-term financial transmission rights, referred to herein as short-term congestion revenue rights (CRR(s)), and the implementation of long-term firm transmission rights (LTTRs) (referred to herein as long-term CRR(s)).[1] This order denies the requests for rehearing and clarification of the July 6 Order.

I. Background

2. On February 9, 2006, in Docket No. ER06-615-000, the CAISO filed its proposed MRTU Tariff that provided for seasonal and monthly transmission rights called short-term CRRs. On September 21, 2006, the Commission issued an order that conditionally accepted the short-term CRRs Tariff provisions, subject to modification.[2] Subsequently, on April 20, 2007, the Commission issued an order on rehearing of the MRTU Order, that directed additional modifications to the proposed short-term CRRs Tariff provisions.[3]

---

[1] *Cal. Indep. Sys. Operator Corp.*, 120 FERC ¶ 61,023 (2007) (July 6 Order).

[2] *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274, at P 704-873 (2006) (MRTU Order), *order on reh'g*, 119 FERC ¶ 61,076 (2007) (MRTU Rehearing Order).

[3] MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 348-411.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

3. On July 20, 2006, the Commission issued a Final Rule which, consistent with the Energy Policy Act of 2005 (EPAct 2005),[4] required independent transmission organizations that oversee organized electricity markets to make LTTRs available that satisfy seven guidelines.[5] On November 16, 2006, the Commission issued an order on rehearing of the Final Rule that required the CAISO to submit its LTTRs proposal to the Commission by the January 29, 2007 deadline established in the Final Rule.[6] The CAISO submitted its proposal, in Docket Nos. ER07-475-000 and ER07-475-001, to implement long-term CRRs under the MRTU Tariff, on January 29, 2007 and amended this filing on February 2, 2007. Subsequently, on May 7, 2007, in Docket No. ER07-869-000, the CAISO amended its long-term CRRs proposal as well as several short-term CRRs Tariff provisions that had been conditionally accepted by the Commission.[7]

4. In the July 6 Order, the Commission conditionally accepted, subject to modification, the CAISO's proposed MRTU Tariff revisions implementing long-term CRRs, which were to become effective on July 9, 2007. The CAISO's LTTR proposal was filed in compliance with the Commission's Final Rule regarding Long-Term Firm Transmission Rights in Organized Electricity Markets.[8] This order also granted in part and denied in part the requests for rehearing on LTTR issues that were raised in the MRTU filing in Docket No. ER06-615-001.[9]

[4] Pub. L. No. 109-58, § 1233, 119 Stat. 594, 958 (2005). Section 217(b)(4) of EPAct 2005 directed the Commission to use its authority to facilitate transmission planning and expansion to meet the reasonable needs of load serving entities (LSEs) with respect to meeting their service obligations and, relevant to this filing, securing LTTRs for long-term supply arrangements made, or planned, to meet such obligations. *Id*.

[5] *Long-Term Firm Transmission Rights in Organized Electricity Markets*, Order No. 681, 71 Fed. Reg. 43,564 (Aug. 1, 2006) FERC Stats. & Regs. ¶ 31,226, at P 108-428 (2006) (Final Rule); *order on reh'g*, Order No. 681-A, 117 FERC ¶ 61,201, at P 12-15 (2006) (Final Rule Rehearing Order).

[6] Final Rule Rehearing Order, 117 FERC ¶ 61,201 at P 116.

[7] CAISO Amendments to Facilitate the Initial Congestion Revenue Right Allocation and Auction Process under the Market Redesign and Technology Upgrade Program and Congestion Revenue Rights For Sponsors of Merchant Transmission Upgrades (May 7, 2007).

[8] Final Rule Rehearing Order, 117 FERC ¶ 61,201.

[9] On July 20, 2007, the CAISO filed the Amendments in Compliance with the Commission's July 6 Order in Docket Nos. ER07-869-001, ER07-475-002, and ER06-615-008. *See* Order Conditionally Accepting Tariff Provisions, Subject to Modification, issued concurrently with the instant order, in Docket Nos. ER07-869-001, ER07-475-002, and ER06-615-008.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

5. The California Public Utilities Commission (CPUC), Imperial Irrigation District (Imperial), and Powerex Corp. (Powerex) filed requests for clarification and/or rehearing of the July 6 Order. Northern California Power Agency (NCPA), Pacific Gas and Electric Company (PG&E), Sacramento Municipal Utility District (SMUD) and San Diego Gas and Electric Company (SDG&E) filed requests for rehearing of the July 6 Order. On August 27, 2007, the CAISO filed an answer to SDG&E's rehearing request.

II. Discussion

A. Procedural Matter

6. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure prohibits answers to requests for rehearing.[10] Accordingly, we reject the CAISO's Answer.

B. Compliance with Final Rule Guidelines

7. The Final Rule established seven guidelines that each transmission organization must satisfy to comply with the Final Rule and EPAct 2005. These guidelines provide transmission organizations with flexibility in the manner in which they are satisfied. For the purposes of this order, only Guidelines 5 and 6, which are described in detail below, are at issue.

1. Guideline 5

> [LSEs] must have priority over non-[LSEs] in the allocation of [LTTRs] that are supported by existing transmission capacity. The transmission organization may propose reasonable limits on the amount of existing transmission capacity used to support [LTTRs].

8. Guideline 5 protects LTTRs used to satisfy native load service obligations. In the Final Rule, the Commission chose not to require LSEs with long-term power supply arrangements to have priority over LSEs that prefer short-term power supply arrangements; that is, LSEs are on equal footing, unless stakeholders agree to an alternative rule. The Final Rule also stated that non-LSEs should be given access to any LTTRs available following the allocation to LSEs.

9. The Final Rule provides transmission organizations and stakeholders with flexibility in determining the level at which LSEs may nominate LTTRs, so long as it meets the reasonable needs of the LSE. It additionally allows transmission organizations

[10] 18 C.F.R. § 385.713(d)(1) (2008).

to propose reasonable limits on the amount of transmission capacity available for LTTRs. Under the Final Rule, transmission organizations and stakeholders are given flexibility to propose an approach for incorporating load growth into the allocation process.

a. Quantity of Long-Term CRRs Released to LSEs in Year 1

i. Verification and Planning Process

1. Historical Reference Period

10. Prior to the start of the CRR allocation process, LSEs must submit documentation that will be used to determine their eligibility in the first year of MRTU to participate in Tiers 1 and 2 of the CRR allocation process.[11] The nominated CRR sources in Tiers 1 and 2 must be verifiably tied to supply sources that were owned or under contract to the LSE during the historical reference period. The historical reference period initially proposed by the CAISO was September 1, 2004 to August 31, 2005. However, in Docket No. ER07-869-000, the CAISO proposed to use calendar year 2006 as the historical

[11] Short-term CRRs are allocated using a three tier process. In each tier, an LSE may nominate only CRRs that it is eligible to request. Annual eligibility is based on each LSE's historical demand. In contrast, monthly allocation is based on an LSE's forecasted demand.

In MRTU Year 1, an LSE may nominate source verified short-term CRRs in Tiers 1 and 2. The source verification process requires an LSE to demonstrate that, during the historical reference period, the LSE was entitled to receive energy from the nominated sources to serve its demand. After MRTU Year 1, the CAISO proposes to replace the source verification process used in Tiers 1 and 2 with a Priority Nomination Process. Under the Priority Nomination Process, LSEs are limited to nominating CRRs that they were allocated in the prior years. Tier 3 in the MRTU Year 1, and Tiers 2 and 3 in subsequent years, is referred to as the free-choice tier because CRR nominations are limited only by each LSE's eligibility, which is based on an LSE's forecasted demand.

Long-term CRRs are allocated in a separate tier (Tier LT), which follows the source verified tiers (i.e., Tiers 1 and 2) in MRTU Year 1 and the Priority Nomination Process in subsequent years.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

reference period. The CAISO stated that this change was offered in response to stakeholder concerns that the 2004-2005 reference period was too far in the past relative to the start-up of MRTU.[12]

11. In the July 6 Order, the Commission accepted the CAISO's proposed 2006 historical reference period. In general, the Commission noted that the historical reference period chosen should be reasonably representative of the period during which the rates will be in effect. Also, the Commission stated that relying on a historical reference period (i.e., a prior time period before market participants had notice that this snapshot would be used for CRR allocation) will ensure that parties do not strategically alter their supply decisions, avoid tainting the bilateral contracting process, and guard against cherry-picking of the most valuable long-term CRRs. In addition, the Commission concluded that it was reasonable for the historical reference period to be the same for short-term CRRs as for long-term CRRs, in part, because long-term CRRs are converted from short-term CRRs that are released in Tiers 1 and 2. Accordingly, the Commission accepted the CAISO's proposal to change the historical reference period to calendar year 2006 for both short-term and long-term CRRs.

12. The July 6 Order rejected SDG&E's proposals to match its CRR holdings (including long-term CRRs) with its future procurement decisions.[13] The Commission found that SDG&E's concerns are best addressed by ensuring flexibility for LSEs to obtain the appropriate CRRs in future years, rather than by modifying the historical reference period.[14] To that end, the Commission noted that it had directed the CAISO to reduce the amount of long-term CRRs that an LSE is eligible to nominate in the first three years of MRTU. Given that change, the Commission found that SDG&E's suggested modifications were not necessary.

13. On rehearing, SDG&E argues that allocating a substantial portion of the available CRRs, based on 2006 procurement patterns, produces an unjust, unreasonable, and unduly discriminatory result. SDG&E states that its lower usage of critical portions of the grid during 2006 (i.e., transmission usage for imports from areas to the east was

[12] We note that a compliance filing relating to similar matters is pending before the Commission. *See* CAISO Docket No. ER08-1059-000. As such, acceptance in this order of aspects of the tariff filing that may be altered or impacted in the subsequent ER08-1059-000 docket, does not constitute prejudgment of those issues.

[13] July 6 Order, 120 FERC ¶ 61,023 at P 157.

[14] *Id*.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

unusually low) will cause it to enter the CRR allocation process with a substantial deficit of CRRs on which to hedge its existing procurement arrangements.[15] SDG&E contends that this deficit will result in significant costs to ratepayers, as it is likely to continue into the future, and will limit its ability to comply with California's renewable requirements in the future. SDG&E claims that other LSEs do not face a similar disadvantage due to their larger size and ability to use different transmission paths to avoid congestion.

14. SDG&E contends that it has shown that the CRR allocation methodology was unjust, unreasonable, and unduly discriminatory such that the Commission was required to establish a remedy to mitigate this result. SDG&E notes that previously the Commission has recognized that the special circumstances of a participant in an organized market may require some deviation from the general rule in order to avoid unjust, unreasonable, or unduly discriminatory outcomes.[16] SDG&E argues that, at a minimum, the Commission should adopt the proposal to purge the initial source verifications upon the expiration of the underlying contracts (i.e. not allow LSEs to participate in the Priority Nomination Process after the underlying contract expires). SDG&E claims that its proposal is endorsed by the CPUC, and is consistent with the CAISO's general policy of not allowing pre-MRTU contracts to create rights that will encumber the efficient use of the CAISO-controlled grid.[17]

15. SDG&E acknowledges that the language in the July 6 Order that reduces the number of long-term CRRs that can be awarded in the initial years of the MRTU market is a marginal improvement to the CAISO's proposal. However, SDG&E asserts that it does not resolve its concerns that the CRR proposal (1) will not allow SDG&E a reasonable opportunity to obtain CRRs suitable for hedging its committed resource portfolio and (2) allows entities to retain valuable CRRs received in the Year 1 CRR

---

[15] SDG&E emphasizes that the problem it faces relates to the ability to hedge current procurement contracts, not future procurement choices as indicated in the July 6 Order. SDG&E August 6, 2007 Request for Rehearing at 8.

[16] *Id.* at 16 (citing *New England Power Pool*, 101 FERC ¶ 61,344, at P 36 (2002); *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 FERC ¶ 61,163, at P 92 (2004); *Southwest Power Pool*, 116 FERC ¶ 61,162 (2006)).

[17] *Id*. at 10. In support of this position, SDG&E explains that the recent amendments to the resource adequacy import capacity assignment protocols provide that the initial preferential assignments based on pre-existing contracts, will not be continued after the underlying contract expires. *Id*. at 11. SDG&E also points to the Path 26 resource adequacy counting procedures recently adopted by the CPUC. *Id.* at 12 (citing *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,164, at P 34 (2007)).

20080728-3036 FERC PDF (Unofficial) 07/28/2008

allocation indefinitely, even when they are not needed. SDG&E explains that merely limiting the conversion of short-term CRRs to long-term CRRs to no more than 20 percent of an LSE's load metric will allow cherry-picking of revenue rights. SDG&E explains that by allowing LSEs to convert 20 percent of their CRR entitlement to long-term CRRs and permitting a large percentage of short-term CRRs to be renewed annually via the Priority Nomination Process, LSEs will be able to retain almost all of the CRRs awarded in Tiers 1 and 2 of the Year 1 allocation. SDG&E contends that the problem may worsen in future years when LSEs may renew initial source-verified CRRs for two or three years and then convert them into long-term CRRs as the threshold increases. SDG&E claims that as a result of the interaction between the Priority Nomination Process and the temporarily reduced long-term CRRs conversion process, LSEs other than SDG&E could lock-up indefinitely more than 50 percent of their total CRR entitlement with priority CRRs obtained through the 2006 resource verification mechanism.

16. SDG&E is concerned that the increasing demand for new generation resources (in particular renewables) in the Imperial Valley and northern Mexico will likely increase the value of Southwest Powerlink (SWPL) CRRs.[18] According to SDG&E, the CAISO is developing a resource verification mechanism for seller's choice contracts, entered into by the California Department of Water Resources, which allow the resource to nominate the facilities that will produce the delivered power. SDG&E claims that this will impose even more limits on its ability to obtain CRRs for the SWPL.

17. SDG&E asserts that its protest articulated why the CAISO proposal is inconsistent with Section 217(b)(4) of the Federal Power Act (FPA), which requires that LSEs be able to "secure firm transmission rights (or equivalent tradable or financial rights) on a long-term basis for long-term power supply arrangements made, or planned to meet their reasonable needs to satisfy their service obligations."[19] SDG&E notes that in similar situations, the Commission has required modifications to long-term transmission right plans and cost allocation and hedging schemes to address disparate impacts on specific stakeholders.

18. Further, SDG&E states that the July 6 Order does not address its arguments that the CRR proposal is inconsistent with FPA section 217(b)(4) and FERC precedent

[18] The Southwest Powerlink is a 500 kV transmission line that runs from Palo Verde/Hassayampa Substation in Arizona to the Miguel Substation in San Diego County, California.

[19] SDG&E August 6, 2007 Request for Rehearing at 18 (citing SDG&E May 29, 2007 Protest at 28-31).

20080728-3036 FERC PDF (Unofficial) 07/28/2008

relating to other Independent System Operator (ISO) market redesigns. SDG&E requests on rehearing that the Commission find both that the CRR proposal violates FPA section 217(b)(4) and that it is unjust, unreasonable, and unduly discriminatory under FPA section 205.

19. Similarly, the CPUC argues in its rehearing request that the Commission's failure to order the CAISO to purge the initial resource verification priorities from the allocation process threatens to make the long-term CRRs allocation and retention methodology unjust and unreasonable. The CPUC also claims that, if the Commission allows LSEs to indefinitely roll-over portions of short-term CRRs through the Priority Nomination Process, the CRR allocation process will prevent utilities from meeting the CPUC's renewable energy goals. Furthermore, the CPUC contends that the failure to eliminate the initial source verifications once an underlying contract expires will result in significant unhedged transmission costs to LSEs that will not use the same pre-MRTU resource in future years. The CPUC elaborates that the Commission's failure to exclude expired contracts from the Priority Nomination Process may harm ratepayers. Finally, the CPUC claims that the Commission's failure to exclude expired contracts from the Priority Nomination Process conflicts with Order No. 681 and section 217(b)(4) of the FPA.

20. SDG&E states that the CAISO has acknowledged that the available mix of CRRs in the future will depend on market participant behavior that cannot confidently be predicted at this time. SDG&E maintains that it has obligations to serve its native load customers in a prudent manner and that "absent some guarantee that its ratepayers will not be subjected to excessive charges under the CRR [a]llocation process, SDG&E is left in an untenable position."[20] Further, SDG&E explains that it will not receive the CRRs that it will need in the future in the initial source-verified allocation and contends that the free-choice nominations for these CRRs in future years will be difficult because LSEs will have the means and strong financial incentives to retain valuable CRRs.

21. SDG&E argues that the uncertainty in the CRR nomination process adds to the initial disparity it faces from the use of 2006 as the baseline. SDG&E explains that it will likely submit nominations in the free-choice tiers of the CRR allocation process after obtaining a smaller percentage of its aggregate entitlement to CRRs in the source-verified tier than the other large California LSEs. Even though SDG&E will start the CRR process with CRR entitlements (and payment obligations) similar to other LSEs, SDG&E claims that the total number of CRRs for those entitlements awarded in Tiers 1 and 2 will likely be lower than those awarded to other California investor-owned utilities (IOUs). If the other IOUs use their remaining entitlements to nominate additional CRRs in the free-

---

[20] *Id.* at 19.

choice tiers that burden the transmission constraints essential to SDG&E's ability to hedge its congestion risk, then SDG&E argues that it will fall further behind in obtaining a comparable level of protection from the financial effects of congestion. SDG&E claims that this situation could be partially mitigated if a process were in place for granting preference in the free-choice tiers to LSEs that have secured a smaller portion of their total CRR entitlement in the earlier tiers.

22. SDG&E asserts that "it is imperative that the Commission make some provision for mitigation of the unreasonable rates that SDG&E ratepayers are likely to experience due to implementation of the CAISO's CRR allocation methodology."[21] SDG&E points out that previously the Commission has noted that "if . . . the actual CRR allocation and auction processes yield outcomes that appear to be unjust and unreasonable, we will revisit the CAISO's methodology of allocating CRRs."[22]

23. SDG&E acknowledges that the MRTU Tariff is the product of compromise and therefore does not provide every market participant with its ideal outcome. SDG&E emphasizes that obtaining reasonable certainty that it will have effective access on reasonable terms to the CRRs it needs in future years is of utmost importance. SDG&E argues that the July 6 Order fails to address its concerns such that, absent significant modifications to the MRTU CRR allocation procedures on rehearing or judicial review, it must reserve the right to consider all options for protecting its ratepayers.

2. Transmission Planning and Expansion

24. The Final Rule requires each transmission organization to implement a planning process that will accommodate the LTTRs that are awarded by ensuring that they remain feasible over their entire term.[23] In the July 6 Order, the Commission further stated that appropriate planning for LTTRs is essential to ensure that any charges to market participants to meet the full funding requirement of Guideline 2 do not become unjust, unreasonable, or unduly discriminatory. The Final Rule requires each transmission organization to make its planning and expansion practices and procedures publicly available.

25. In the July 6 Order, the Commission supported the CAISO's efforts to initiate a collaborative and transparent transmission planning process. The Commission agreed

[21] *Id.* at 21.

[22] *Id.* (citing MRTU Order, 116 FERC ¶ 61,274 at P 743).

[23] July 6 Order, 120 FERC ¶ 61,023 at P 217.

that any such planning process would also be subject to the requirements of Order No. 890, within the timeframe prescribed therein. Accordingly, in a timeframe consistent with the CAISO's compliance obligations under Order No. 890 or within six months after the start of MRTU markets, whichever is sooner, the Commission directed the CAISO to make a compliance filing in this proceeding that explains how its transmission planning process will help to ensure that long-term CRRs remain feasible over their entire term.[24]

26. On rehearing, the CPUC requests clarification that the Commission conditioned the gradual increase of grid capacity available for long-term CRRs upon the CAISO developing a plan to provide for the successful long-term integration of new grid elements and hedges for those additions into the long-term CRRs allocation methodology in a non-discriminatory manner. The CPUC claims that, although the CAISO has begun a stakeholder process to discuss methodologies that would assure the long-term feasibility of awarded long-term CRRs, it is not clear that the stakeholder process will also create a plan that assures that long-term CRRs will be available to hedge the transmission costs of future generation. The CPUC argues that, if such long-term CRRs are not available, the tariff language will discriminate between LSEs using new resources to serve load and those having contracts with existing generation.

27. If the Commission declines to provide this clarification, the CPUC seeks rehearing. According to the CPUC, the Final Rule requires that "long-term firm transmission allocation methodologies should not become unjust, unreasonable, or unduly discriminatory over time and should provide transmission hedges for future energy supply agreements."[25] The CPUC also explains that LSEs' inability to obtain hedges for the transmission costs of future generation may harm ratepayers, who will ultimately pay the unhedged transmission costs. Furthermore, the CPUC argues that such a hedge is necessary in order to respect California's energy procurement choices and to prevent discriminatory treatment between new and existing resources.

Commission Determination

28. We deny both SDG&E's and the CPUC's requests for rehearing. We find that the CAISO's proposed source verification process and its use of the 2006 historical reference

[24] *Id.* P 222. The Commission also found that there were no issues of material fact that necessitated an evidentiary hearing. *Id*.

[25] CPUC August 6, 2007 Rehearing Request at 4 (citing Final Rule, FERC Stats. & Regs. ¶ 31,226 at 453; July 6 Order, 120 FERC ¶ 61,023 at P 217; *see also Allegheny Power Sys. Operating Cos.*, 111 FERC ¶ 61,308 (2005); *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 9-10 (D.C. Cir. 2002)).

20080728-3036 FERC PDF (Unofficial) 07/28/2008

period is a reasonable means to establish "priority" CRR nominations in MRTU Year 1.[26] We also find that the Priority Nomination Process, which replaces the source verification process in MRTU Year 2, is an important design element that provides LSEs with increased certainty that they will be able to keep the CRRs they need going forward. In addition to these elements, the CAISO's CRR design provides LSEs with flexibility to nominate CRRs in free-choice tiers. These free-choice CRR nominations provide LSEs with access to CRRs to hedge congestion costs associated with resources procured after the historical reference period. Additionally, we note that our action in the July 6 Order limits the amount of long-term CRR capacity released in the first three years of MRTU, which helps ensure that grid capacity for short-term CRR nominations will remain available as market participants gain experience under MRTU.[27] Thus, we reiterate that our prior action addresses SDG&E's concerns.[28] In sum, we disagree that further action is required at this time, and we reaffirm our prior determination that the historical reference year and Priority Nomination Process features of the CAISO's long-term CRRs design are just, reasonable, and not unduly discriminatory.

29. As the Commission explained in its July 6 Order, "the historical reference period chosen should be reasonably representative of the period during which the rates will be in effect."[29] However, it should be chosen enough in advance of MRTU so that procurement decisions are not affected by parties interested in simply obtaining valuable CRRs.[30] We find that the CAISO's proposed 2006 historical reference period accomplishes these goals, as it is reasonably representative of the period during which the rates will be in effect and it was chosen far enough ahead of MRTU so that parties cannot change their procurement decisions, which have already been made, to obtain valuable CRRs. Additionally, as the CAISO and its stakeholders transition into MRTU, it is imperative that the allocation process releases CRRs that hedge LSEs against the congestion costs that they will incur. We find that recent history is a reasonable indicator

---

[26] For the purpose of this order, priority CRR nominations are defined as CRR nomination in Tiers 1 and 2 in MRTU Year 1, and Tier 1 (the Priority Nomination Process) in all subsequent years.

[27] *See* July 6 Order, 120 FERC ¶ 61,023 at P 136.

[28] *See id*. P 157.

[29] *See id*. P 155.

[30] *See id*.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

of the congestion charges that LSEs will incur in MRTU Year 1.[31] Therefore, by linking priority CRR nominations with existing resources, the CAISO's proposal provides all LSEs, on a nondiscriminatory basis, with the best opportunity to hedge the congestion costs that they will actually incur while serving their loads. We find that the CAISO's proposal to limit Year 1 priority CRR nominations to those CRRs that are source verified during the 2006 historical reference period is a design feature that will benefit all LSEs alike, and we disagree that it is unduly discriminatory against any particular LSE.

30. As modified by the Commission, the CAISO's proposal strikes an appropriate balance between providing LSEs with a high degree of certainty that LSEs can acquire and keep the CRRs associated with existing contracted resources, and providing LSEs with the flexibility to request new CRRs associated with future procurement decisions. An important component of this balance is the Priority Nomination Process, in which MRTU Year 1 CRRs awarded through the source verification process will be eligible for nomination by LSEs in the Priority Nomination Process starting in MRTU Year 2 and beyond. Together, the use of a historical reference period for MRTU Year 1 coupled with the implementation of the Priority Nomination Process in subsequent years, provides LSEs with the ability to hedge the congestion costs they incur at the start of MRTU, and provides reasonable certainty that they can retain this hedge going forward. We are not persuaded that this outcome is problematic.

31. Instead, consistent with the Final Rule,[32] the CAISO's proposal provides LSEs with a degree of certainty that they can either acquire long-term CRRs or renew short-term CRRs. While long-term CRRs provide LSEs with a guarantee that they will be hedged against congestion for the 10-year term of the CRR, the Priority Nomination Process provides LSEs with increased certainty that they will be able to renew their short-term CRRs on an annual basis. For some LSEs, this annual renewal process may be preferred because it provides them with the flexibility to modify their CRR portfolio each

---

[31] The Commission also notes that the CAISO's filing in Docket No. ER08-1059-000 proposes, among other things, to redefine the historical reference period to cover the period from, and including, the second quarter of 2006 through, and including, the first quarter of 2007. *See* CAISO May 30, 2008 Transmittal in Docket No. ER08-1059-000. While the CAISO proposes to redefine the historical reference period in that docket, we nonetheless must consider the original historical reference period in this docket because the proposed modifications in ER08-1059-000 do not impact CRRs already released. In the instant proceeding, the Commission is not determining whether that proposal is just and reasonable. Nonetheless, to the extent that the Commission approves such proposal, use of first quarter 2007 data, could further alleviate SDG&E's concerns that its transmission usage for imports was unusually low in 2006.

[32] *See* Final Rule Rehearing Order, 117 FERC ¶ 61,201.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

year. If an LSE changes its supply portfolio, or if congestion patterns under MRTU are different than anticipated, LSEs may choose not to renew certain CRRs, or they may nominate new CRRs in the free-choice tiers. This flexibility coupled with the increased certainty provided by the Priority Nomination Process are important design features that we are not inclined to modify. Accordingly, we deny SDG&E's rehearing requests to modify this feature.

32. Additionally, the CRR release process affords LSEs the flexibility to nominate non-source verified CRRs in the free-choice tiers. This provides LSEs with access to CRRs associated with resources that the LSE was not using during the historical reference period. This is also true for SDG&E. The Commission's action, phasing in long-term CRR eligibility over a multi-year period, in the July 6 Order helps to ensure that market participants do not unnecessarily "lock-up a significant portion of grid capacity as long-term CRRs in year one, reducing flexibility for LSEs in later years."[33] However, in reducing the availability of long-term CRRs in the first year, the Commission noted that the Priority Nomination Process provided market participants with "reasonable certainty that they can retain their short-term CRR holdings in subsequent years."[34] In the instant proceeding, we disagree with SDG&E that further action limiting LSEs' ability to retain source-verified short-term CRRs is warranted. We find that the balance struck between providing LSEs reasonable certainty that they can keep the CRRs associated with existing contracted resources and providing LSEs with the flexibility to request new CRRs associated with future procurement decisions is reasonable. We also find that modifying the Priority Nomination Process to purge the initial source verifications upon the expiration of the underlying contract may upset this balance.

33. Moreover, we are not persuaded by SDG&E's argument that it faces unique circumstances that warrant modification of the CAISO's proposal. SDG&E notes that the Commission has recognized special circumstances in other organized markets. SDG&E fails to demonstrate that the CAISO's proposal must be modified in order to prevent unduly discriminatory outcomes. All LSEs face similar challenges regarding acquisition of CRRs for future sources. This is true for LSEs re-nominating source verified CRRs as well as for LSEs nominating new CRR requests based on contracts signed after the historical reference period. SDG&E's treatment under the filed CAISO proposal is consistent with other LSEs and is not unduly discriminatory. Further, SDG&E raises concerns regarding the CAISO's implementation of CRRs relating to seller's choice contracts. In this regard, if the CAISO modifies its CRR proposal, the Commission will review the merits of such a proposal once it is before us.

[33] *See* July 6 Order, 120 FERC ¶ 61,023 at P 136.

[34] *See id.* P 137.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

34. We also reject SDG&E's assertions that the CAISO's proposal is not consistent with Congress's intent and section 217(b)(4) of the FPA[35] and that it is unjust, unreasonable, and unduly discriminatory under section 205 of the FPA. We find that the CAISO's proposal includes adequate safety features, i.e. the ability to nominate short-term CRRs in the free-choice tiers and the ability to trade allocated CRRs. Accordingly, we disagree with the assertions by the CPUC and SDG&E that SDG&E's ratepayers will be adversely affected by the CAISO's current proposal because, as discussed elsewhere herein, the Commission has found that the CRR release process is a reasonable approach to allocating CRRs to hedge congestion costs. We also disagree with SDG&E's contention that the CAISO's proposal is inconsistent with Commission precedent and note that SDG&E fails to provide evidence on this point.[36]

35. The Commission also denies the CPUC's request for clarification that we "conditioned the gradual increase of grid capacity available for [long-term CRRs] upon [the] CAISO developing a plan to successfully integrate new grid elements and hedges for those additions into the [long-term CRRs] allocation methodology in a non-discriminatory manner."[37] As discussed above, we find that the CAISO's filed proposal is just and reasonable. Additionally, because the CAISO is subject to the planning requirements of Order No. 890, we believe that the CAISO's Order No. 890 compliance

[35] FPA section 217(b)(4) states "The Commission shall exercise the authority of the Commission under this Act in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities to satisfy the service obligations of the load-serving entities, and enables load-serving entities to secure firm transmission rights (or equivalent tradable or financial rights) on a long-term basis for long-term power supply arrangements made, or planned, to meet such needs." 16 U.S.C. § 824q(b)(4).

[36] SDG&E claims that the July 6 Order does not provide for such an ongoing review. On rehearing, SDG&E urges the Commission to reaffirm its commitment to oversee the implementation process to ensure that the interests of all California ratepayers are protected. SDG&E requests that if one of its remedies is not adopted, the Commission should establish a process requiring an annual review of the CRR allocation process and reserve the right to order changes. The Commission notes that under section 206 of the FPA, it has the right to institute an investigation and order appropriate changes. *See* 16 U.S.C. § 824e (200 and Supp. V 2005).

[37] CPUC August 6, 2007 Rehearing Request at 2.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

proceeding in Docket No. OA08-62-000, in which the CPUC intervened and filed comments, appropriately addressed the CPUC's concerns.[38] For these reasons, we also deny the CPUC's request for rehearing on this matter.

36. Finally, while we deny SDG&E's and the CPUC's requests to modify elements of the CAISO's Priority Nomination Process, parties are free to consider modifications to the CAISO's CRR allocation process in future stakeholder initiatives on this issue. As an example of such initiatives, in its July 6 Order, the Commission stated that "in the case of an LSE holding a CRR associated with ownership of a [resource] that is being shut down or a contract for energy that is expiring, it may be desirable to have a mechanism for allowing the LSE a right to nominate a new CRR in a 'priority' tier."[39]

ii. <u>Intertie Set-Aside Provision</u>

37. In the MRTU Order, the Commission conditionally accepted the short-term CRRs provisions but directed the CAISO to evaluate whether its proposal to set aside 50 percent of the intertie capacity needed to be modified based upon the results of the CRR dry run. In the July 6 Order, the Commission disagreed that the results of the CRR dry run showed that the intertie set-aside provision was ineffective. Instead, as Powerex recognized, the Commission found that the CRR dry run results revealed that there was intertie capacity remaining after the allocation process.[40] The Commission stated that this intertie capacity was available for non-LSEs wanting to purchase CRRs in the auction process. The Commission disagreed that the provisions relating to setting aside intertie capacity should include mechanisms to preserve internal capacity.[41] The Commission explained that, if intertie-sourced CRR nominations are infeasible because of internal constraints, it is not because the CAISO's rules for auctioning intertie capacity are defective. Instead, it is because there is limited physical transmission capacity and internal LSEs are using all available internal capacity to serve their load. Furthermore, the Commission stated that unlike internal LSEs that will ultimately pay congestion charges at the location of their load, Powerex could modify its CRR nomination to avoid areas of the grid that are typically constrained. The Commission added that, if Powerex wanted to increase its chances of receiving its desired CRRs, it could offer to pay more for these CRRs in the auction process. Finally, the Commission noted that LSEs and

---

[38] *Cal. Indep. Sys. Operator Corp.,* 123 FERC ¶ 61,283 (2008).

[39] July 6 Order, 120 FERC ¶ 61,023 at P 100.

[40] *Id*. P 140.

[41] *Id*.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

marketers such as Powerex were not similarly situated because EPAct 2005[42] requires that LSEs get priority treatment; therefore, there was no undue discrimination. For these reasons, the Commission did not direct the CAISO to modify either the method of modeling set-aside intertie capacity or the rules governing the allocation tier to which the set-aside provision is applied.

38. On rehearing, Powerex claims that the Commission erred when (1) it accepted the CAISO's proposal without evidence that the intertie capacity set-aside rules in Year 2 and beyond of MRTU were just and reasonable, and (2) it ordered the phase-in of long-term CRRs but did not require the CAISO to evaluate and report on the results of the CRR distribution during the phase-in. Powerex explains that the value of the phase-in is hindered by the absence of a process to find and fix problems. Specifically, Powerex points to the lack of a mechanism or process for evaluating the adequacy of the intertie capacity set-asides in the Year 2 and beyond. Powerex acknowledges that rule changes will not be needed if a significant amount of intertie capacity is available in the auction each year. However, Powerex argues that if a material decline occurs in the quality and quantity of intertie capacity available in the auction, then the issue should be subject to a Commission proceeding where the Commission can direct any rule changes needed to maintain the ability of external suppliers to take part in the CAISO markets.

39. Powerex adds that, contrary to both the original MRTU proposal and the Commission's concern in the MRTU Order about the sufficiency of capacity set aside for auction, the July 6 Order fails to distinguish between intertie capacity that is set aside for auction and the creation of additional CRRs in conjunction with counterflow CRRs. Powerex claims that this "conflation obscures the distinction between the original capacity of the grid and secondary financial transactions."[43] Powerex further asserts that, if the intent had been to limit the auction to CRRs paired with counterflow CRRs, then there would have been no need for a set-aside of intertie capacity.

40. Powerex requests that the Commission clarify or grant rehearing that the CAISO should submit reports on its CRR distributions to the Commission for public comment. Powerex requests that the reports include (1) data similar to the data provided for financial transmission rights auctions (i.e., the source and sink, buyer, quantity, and price presented by branch group and buyer), and (2) CRR allocation data similar to the intertie import allocation tables that identify which LSE received financial transmission rights on the interties. Powerex also requests that the CAISO provide appropriate explanatory

[42] Energy Policy Act of 2005, Pub. L. No. 109-58, § 1289, 119 Stat. 594, 982-83 (2005) (to be codified at 16 U.S.C. § 824b(a)(4)).

[43] Powerex August 6, 2007 Rehearing Request at 13.

information to facilitate analysis of the results. Powerex states that, if the reports show that the number of intertie CRRs available in the auction decreases significantly, then the CAISO should evaluate how to make more intertie capacity available in the auction.

Commission Determination

41. We deny Powerex's request for clarification and/or rehearing. As explained in the July 6 Order, LSEs and marketers such as Powerex are not similarly situated because EPAct 2005 requires that LSEs receive priority treatment.[44] Accordingly, the Commission is not required to evaluate whether intertie capacity set-aside rules or the phase-in approach to allocating long-term CRRs affords non-LSEs with sufficient opportunity to purchase intertie sourced CRRs. Instead, we are required to evaluate the CAISO's proposal in the context of the Commission's Final Rule. In light of these facts, we reaffirm our finding that the CAISO's proposal is just and reasonable and that it satisfies the requirements set forth in the Final Rule.

42. Consistent with EPAct 2005, the Final Rule requires that LSEs receive priority treatment through the direct allocation of CRRs. Under the CAISO's proposal, marketers such as Powerex can purchase CRRs either bilaterally or in the CRR auction that follows the allocation process. Contrary to Powerex's assertion that the Commission failed to distinguish between set-aside intertie capacity and the auctioned intertie-sourced CRRs that are paired with counterflow CRRs, we again find that the CRR release process provides non-LSEs with reasonable access to intertie-sourced CRRs through both the set-aside provisions that exist in the allocation process and the CRR auction that follows. If Powerex desires more intertie-sourced CRRs than the set-aside provision provides, the CRR release process affords Powerex the opportunity to bid for these CRRs in the auction. Because LSEs are required to receive priority treatment and non-LSEs are not similarly situated, there is no undue discrimination. Nonetheless, we find that these set-aside provisions coupled with the CRR auction provides non-LSEs with sufficient access to intertie-sourced CRRs. We note that if only limited capacity is available to non-LSEs, it is because LSEs need the capacity to hedge the congestion costs that they actually incur when serving their load. We disagree that this outcome is inconsistent the Commission's Final Rule.

43. Finally, consistent with other locational marginal price (LMP) based markets, we expect the CAISO to publish the results of the CRR release process in a manner that is consistent with the applicable non-disclosure agreements. As a result, we will not require the CAISO to file a separate CRR distribution concerning the phase-in with the Commission.

---

[44] *See* July 6 Order, 120 FERC ¶ 61,023 at P 140.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

b. Access of Small LSEs to Long-Term CRRs

44. In the July 6 Order, the Commission found that the rules established under the long-term CRRs proposal treat all LSEs alike. The Commission anticipated that the first few years of MRTU will provide valuable experience, and, accordingly, expected market participants to consider the newness of the market when making their initial long-term CRRs nominations.[45] In addition, the "go slow" approach that the Commission accepted for the release of long-term CRRs provides LSEs with a further means to gain experience with the long-term CRRs allocation process. The Commission noted that some market participants desire additional information about the data and the assumptions used in these studies, and the CAISO has made such information available to market participants who sign a non-disclosure agreement.[46]

i. CAISO's Proposal for Long-Term CRRs Fails to Satisfy the Statutory Requirements of the FPA

45. On rehearing, NCPA objects to the CAISO's long-term CRR proposal based on the following two concerns: (1) that the proposed instruments (particularly the obligations nature of the instrument, combined with its volatility and the collateral requirement) are too speculative and risky to accomplish the statutory goal of allowing LSEs to hedge long-term power supply arrangements in a predictable manner, and (2) that the risks are troubling for small LSEs that will have a lesser ability to effectively diversify their long-term CRRs positions because they have smaller long-term CRR portfolios, leading to potentially greater volatility.

46. On rehearing, NCPA objects to the Commission's treatment of its contention that long-term CRRs instruments are too speculative and risky to accomplish the statutory goal of allowing LSEs to hedge long-term power supply arrangements in a predictable manner. NCPA contends that the Commission attempted "to rely on its general conclusion in Order 890 that obligations instruments in general may satisfy the statutory requirements to reach an unsupported assertion that the CAISO's [long-term CRRs] proposal for obligations instruments does the same, without addressing any of the actual issues with the CAISO proposal in the context of the CAISO markets raised by NCPA and others."[47] NCPA further asserts that the Commission erred when it stated that it

[45] *Id.* P 168.

[46] *Id*.

[47] NCPA August 3, 2007 Rehearing Request at 10.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

understands the relative conceptual merits of the obligations and options methodologies and, therefore, declined to hold a hearing or otherwise consider the specific issues raised by NCPA.

47. On rehearing, NCPA states that it is limited in its ability to use long-term CRRs due to their speculative nature, which is counterintuitive to the nature of a hedge, and to the purpose of the statute.[48] NCPA provides that publicly-owned entities tend to operate conservatively and generally discourage use of unpredictable or speculative instruments.

48. NCPA explains on rehearing that, for entities trying to determine what short-term CRRs or long-term CRRs to request, it is a problem that it is not possible to know which CRRs are which, because the information needed to forecast LMP prices is limited or not available and the CAISO's underlying calculation for deriving LMP prices is not available to market participants so that they can duplicate the CAISO's results.[49] NCPA explains that it has performed its own LMP studies to try and project LMP pricing in order to guide its CRR selection and mitigate CRR market risks. However, NCPA states that verifying the accuracy of the calculation has been difficult and results in price uncertainty. NCPA provides that there is no history of LMP prices in California and due to the limited amount of information on potential LMP prices, it is possible that LSEs will not always make the best choices in the CRR nomination process.

49. NCPA asserts that small LSEs cannot rely on the CAISO's generalization that they can be safe by designating CRRs from their baseload resources to their loads, simply assuming that any negative or positive CRR values will be equally offset by the negative or positive settlement for congestion at the source. NCPA states that this appears to be the only basis for the Commission's determining that volatility is not a large factor.

---

[48] *Id.* at 12-13. NCPA states that CRRs are fundamentally speculative and that the CAISO has emphasized this point in its filings explaining why it believes that it is necessary to impose significant collateral requirements on holders of CRRs and long-term CRRs. *Id.* at 11-12 (citing June 12, 2007 CAISO Filing Letter in Docket Nos. ER07-1077-000 and ER07-613-004). NCPA argues that the intent underlying the statutory directive to develop LTTRs was to permit LSEs to hedge against LMP congestion costs, at least for baseload resources, and to plan for new baseload resources. *Id.* at 12.

[49] *Id.* at 14. NCPA states that it was "particularly disadvantaged in this regard due to the CAISO's failure to make the network model and related CRR information available under the terms of a reasonable non-disclosure agreement." *Id*. at n.18. NCPA also notes that the Commission ordered modifications to CAISO's non-disclosure agreement in *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,313, at P 40 (2007) (MRTU Compliance Order).

20080728-3036 FERC PDF (Unofficial) 07/28/2008

NCPA explains that the possibility is overlooked that generation resources may become unavailable for extended periods of time due to forced outages, retirements or other reasons, thereby exposing LSEs to the risks of negatively-valued CRRs and the associated collateral requirements. NCPA asserts that the Commission did not address "the potentially catastrophic effect" of a forced retirement or accident involving extended repair times on the holder of negatively valued long-term CRRs.[50] Also, NCPA asserts that the CAISO's proposal is unsuitable to the development of hydroelectric or renewable resources that often cannot and should not operate on a baseload model.

50. NCPA states that the CAISO has developed LMP projections for a limited term and only one market simulation that would give market participants an idea of the range of LMP prices, or their effect on CRR values. NCPA argues that this is thin data from which to determine what future CRR positions an LSE should seek and that, without more extensive data, it will be both difficult and speculative for LSEs to estimate the possible risk associated with obligations long-term CRRs, or the estimated collateral that could be required for such rights.

51. On rehearing, NCPA claims (1) that both of the CAISO's LMP studies had varying results and provide significantly different congestion results and (2) that the CAISO has made very limited attempts to explain these differing results. NCPA notes that in some cases both of the CAISO's studies reflect opposite congestion values, making it hard to predict the expected congestion value at that source.[51] NCPA further asserts that the CAISO's use of uncertainty as a justification for conservative credit requirements is at odds with its assertion that LSEs can safely choose positively-valued CRR portfolios.

52. NCPA argues that the risk associated with long-term CRRs is exacerbated by the fact that the values for long-term CRRs, and the collateral required to hold them, will not be known until after CRRs have been allocated and long-term CRRs designated. NCPA explains that the CAISO will determine the amount of credit required, in accordance with the value of the CRR, which is established through an auction following the CRR allocation process. Upon receiving the credit requirement, NCPA claims that an LSE will not be able to return the long-term CRRs because the CAISO may be relying on the

---

[50] *Id.* at 15.

[51] *Id*. at 17. NCPA notes that the CAISO's affiant, Dr. Harvey, appears to agree with NCPA's assessment of the nature of CRR risk. *Id.* (citing Harvey Affidavit in CAISO Filing in Docket Nos. ER07-1077-000 and ER07-613-004 at P 29).

20080728-3036 FERC PDF (Unofficial) 07/28/2008

counterflows to support other CRRs. NCPA states that if the CAISO desires conservative collateral requirements due to volatility of CRR values, it is not clear why it or the Commission expect LSEs to possess better knowledge.

53. NCPA contends (1) that the ability of long-term CRRs to change in value over time is a source of risk, and (2) that changes in grid usage can and will change prices at various nodes. As such, NCPA is concerned that a long-term CRR holder faces the possibility that its hedge could change in value, or even shift from positive to negative, with the result of locking the holder into years of payments.

54. On rehearing, NCPA argues that the ability of an LSE to use the long-term CRR process to hedge transmission costs for new, planned baseload generation is the touchstone for whether the CAISO's long-term CRR proposal complies with statutory and Commission requirements. NCPA asserts that the proposed long-term CRR construct does not allow entities to reserve long-term CRRs to begin at some point in the future.[52] In a situation where a new resource is being constructed that will alleviate congestion when it comes on-line, NCPA argues that an obligation CRR would be expected to have a negative value for at least the years when construction is ongoing. NCPA states that in order to site a resource in a beneficial location, it must undertake years of long-term CRRs obligations payments and the corresponding expense of collateral requirements in order to ensure access to these hedging instruments when the resource comes on-line. NCPA submits that such an instrument and the associated risks will have a chilling effect on investment in future generation. NCPA asserts that "the whole concept is entirely antithetical to the intent of Congress in enacting [EPAct 2005] and is a heavy burden to impose on society for no consequent value, except to discourage building generation where it should logically go, to the resultant benefit solely of speculators."[53]

55. NCPA claims that the Commission has not responded to its scenario beyond noting that the availability of seasonal and time-of-use CRRs help reduce the potential for

[52] *Id*. at 20. NCPA explains that this is a problem because the timeline for construction of a resource could span years and in order to obtain financing, NCPA must be able to ensure transmission availability and cost. To assure access, NCPA elaborates that it should seek an allocation of CRR rights when the site is identified, because it cannot be certain what other changes might impact access to transmission during the construction period, and to prevent other entities from locking up access once the project is started. NCPA claims that it should also seek to convert the CRRs to long-term CRRs to lock in availability for the resource. *Id*.

[53] *Id*. at 21.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

obligation payments. According to NCPA, seasonal and time-of-use variations are helpful for addressing predictable variations in generation output due to seasonal factors; however, they do not address a scenario where something goes wrong under a long-term instrument, and they have little impact on planning future generation where the holder must obtain long-term rights for generation that is not yet operational.

56. NCPA raises concerns about the risk derived from obligation CRRs.[54] Specifically, NCPA asserts that, if due to a catastrophic outage or change in environmental laws resulting in new limitations on how often or how long a unit may run, negatively-valued long-term CRRs for that resource could result in years of payments. NCPA contends that a partial fix to this scenario would be to require the CAISO to allow the return of negatively-valued long-term CRRs associated with retired plants or plant shut downs due to regulatory changes.

57. NCPA states that obligation long-term CRRs cannot convey price certainty, and that when paired with potentially onerous collateral requirements, the risk of holding the hedge becomes too great for some to bear. Further, NCPA provides that in the context of negatively-valued long-term CRRs where the resource cannot run for a long period, or in the context of planning future power supply arrangements, long-term CRRs can be costly to the holder. As such, NCPA asserts that a hedge that makes it more risky to maintain or enter into long-term power supply arrangements cannot be what Congress intended.

58. NCPA states that one solution proposed in the stakeholder process was for the CAISO to develop option CRRs for conversion to long-term CRRs. Although the result may be that there are fewer CRRs, NCPA contends that the CAISO has not provided data on the potential impact.[55] NCPA asserts that other solutions may be achieved by reducing collateral requirements, or addressing the problems occurring in instances of unplanned long-term outages or in planning new generation.

[54] NCPA explains that the difference between options and obligation CRRs is that options CRRs carry no risk if the holder cannot schedule the resource covered by a negatively-valued CRR, whereas obligation CRRs for a negatively-valued rights require a net payment if the resource is not scheduled. *Id*. at 19.

[55] *Id*. at 24. The NCPA points out that this solution has never been fully considered and would probably delay MRTU, or require conditioning CRRs and long-term CRRs issued while it is developed. *Id*.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

ii. The Long-Term CRRs Proposal Discriminates Against Small LSEs

59. NCPA claims that the risk of negative allocations is much greater for smaller entities than for the large IOUs. NCPA maintains that due to the size of the loads and generation resources, PG&E and SoCal Edison will be able to hold large portfolios of long-term CRRs (along with seasonal and monthly CRRs), which permits them to diversify their holdings across the grid. NCPA argues that because the collateral requirements are calculated based on the net value of a holder's CRR portfolio, entities with large portfolios will have better odds that their total portfolios will yield an average positive value.[56] In contrast, NCPA asserts that because small entities will be entitled to smaller amounts of long-term CRRs, the risk of those instruments developing a net negative value over time could be greater due to their limited ability to diversify between resources. NCPA objects to this imposition of disproportionate risk on small LSEs.

60. NCPA contends that California's commitment to universal rates will mean that regardless of LMPs and, maybe eventually, nodal pricing for loads, IOU customers will not pay more than the average transmission rate spread across a company's entire load. NCPA states that the consequences for small LSEs who lack a large, diverse load base over which to average costs, and which tend to be located at individual nodes, means that some small LSE customers, especially in congested areas, are positioned to face more serious price dislocations. NCPA asserts that the CAISO's proposal must be modified to not be unduly discriminatory under the FPA and anticompetitive toward small LSEs.

iii. The Commission Must Consider the CAISO's Proposed Collateral Requirements for Long- Term CRRs in the Context of the CAISO's Entire Proposal

61. NCPA argues that the Commission did not address the CAISO's long-term CRR proposal with regard to the CAISO's credit and collateral requirements for long-term CRRs because they are pending in another docket. However, NCPA reiterates that the CAISO cannot evade review of the entire proposal.

[56] *Id*. at 25. NCPA further claims that PG&E and SoCal Edison "provide the major inputs for the CAISO planning process and supply project proposals, and also select the projects they will build, thus giving them much more knowledge of what flows are likely to change and much more influence within the CAISO planning process and its impacts on existing [long-term CRRs]." *Id*. at n.43.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

Commission Determination

62. The Commission denies NCPA's request for rehearing. We disagree with NCPA's contention that we have violated section 217(b)(4) of the FPA and the Final Rule. Under section 217(b)(4), the Commission is required to exercise its authority "in a manner that facilitates the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities to satisfy the service obligations of the load-serving entities, and enables load-serving entities to secure firm transmission rights (or equivalent tradable or financial rights) on a long-term basis for long-term power supply arrangements made, or planned, to meet such needs."[57] NCPA's claims that we have violated the statute are based largely on its allegations that we have not addressed specific situations that it alleges do not satisfy the statutory standard or are otherwise unreasonable. For the reasons described below, we find that NCPA's assertions that the CAISO's proposal violates both the FPA and Final Rule are without merit and that the CRR proposal does not expose smaller LSEs to disproportionately greater financial risks.

63. With respect to price uncertainty under MRTU, the Commission has previously acknowledged that congestion patterns may be different under an LMP-based market and that LSEs need to consider many factors when requesting CRRs, especially long-term CRRs. For these reasons, the Commission adopted the "go slow" approach stating that the "first few years of MRTU will provide valuable experience, and, accordingly, we would expect market participants to consider the newness of the market when making their initial long-term CRR nominations."[58] In addition, we reasoned that the "go slow" approach provides LSEs, small and large alike, with a means to gain experience with the long-term CRR allocation process.

64. Market participants should be provided with sufficient information prior to the start of MRTU to help predict their exposure to congestion charges. To help ensure this outcome, the Commission has taken action, which includes directing the CAISO to file the results of the CRR dry run with the Commission.[59] We additionally conclude that NCPA's concern about the lack of pricing information provided to LSEs is without merit because the CAISO has made the information concerning the assumptions used in its studies available to market participants who sign a non-disclosure agreement. In the July 6 Order, the Commission found that the CAISO's non-disclosure agreements governing the release of this type of information were not before us. Subsequently, NCPA's concerns regarding the non-disclosure agreements were addressed in the MRTU

[57] 16 U.S.C. § 824q(b)(4).

[58] July 6 Order, 120 FERC ¶ 61,023 at P 168.

[59] MRTU Order, 116 FERC ¶ 61,274 at P 741.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

Compliance Order.[60] We also find that NCPA's concerns regarding the allegedly contradictory studies are unsubstantiated, as the example provided by NCPA is limited and does not demonstrate that the studies are flawed.

65. The Commission finds that NCPA's concerns about the "potentially catastrophic effect" of a forced retirement or accident involving long repair times on the holder of a negatively valued CRR, and the application of the CAISO's proposal to hydroelectric or renewable resources, which NCPA asserts cannot and should not run on a baseload model, are unsupported by the record. Moreover, we find that the congestion revenue associated with the baseload resource will offset any potential charges associated with corresponding CRRs that are sourced at the baseload resource and are negative in value. In regard to unexpected outages, we find that the potential exposure should be negligible over the term of the CRR. Also, with respect to NCPA's concerns regarding resource retirements, we encourage NCPA to take potential retirements into consideration when requesting CRRs. We note that under the CAISO's proposal, LSEs nominate the CRRs that they want and are never assigned CRRs that they have not requested. That said, it is the nature of counterflow CRRs that the holder may become liable for payments when the underlying unit is not running.[61] However, the Commission finds that the LSEs are in the best position to weigh these risks in their selection of which CRRs to nominate. Further, the benefits of obligation CRRs, which include increasing the number of CRRs available to LSEs, over option CRRs have been previously explained by the Commission.[62]

66. With respect to NCPA's concern that the long-term CRRs construct does not allow an entity to reserve long-term CRRs to begin in the future, we find that NCPA neither provides sufficient detail regarding how its proposal for reserving CRRs would work nor does it demonstrate that the current release process is an unreasonable approach to allocating CRRs associated with resources procured in the future. Therefore, we will not direct such a modification at this time. Additionally, as explained herein, the CRR release process provides LSEs with sufficient access to CRRs associated with future sources by permitting LSEs to nominate such sources in the free-choice tiers. Accordingly, we deny NCPA's rehearing request to "reserve" future CRRs and find that

---

[60] We directed the CAISO to revise the non-disclosure agreement to reflect (1) the CAISO receives litigation costs only if it prevails in litigation, and (2) market participants may use the Full Network Model and related studies in pleadings before the Commission, and treated as privileged information if necessary. MRTU Compliance Order, 119 FERC ¶ 61,313 at P 40; *see also* MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 209.

[61] We reiterate elsewhere herein our finding that obligation CRRs, which result in more CRRs being available, are just and reasonable and not unduly discriminatory.

[62] July 6 Order, 120 FERC ¶ 61,023 at P 223.

the CAISO's proposal, is in compliance with the Final Rule and is just, reasonable, and not unduly discriminatory in its approach to allocating CRRs in MRTU Year 2 and beyond.

67. We find that, in its assertion that the CAISO's proposal is inconsistent with Congress's intent, NCPA misconstrues the facts.[63] Specifically, NCPA alludes that under the CAISO's proposal, long-term CRRs increase the risks associated with entering into long-term power arrangements. We find that this contention is unsupported by the record. Under the CAISO's proposal, long-term CRRs are an optional mechanism that LSEs may choose to request in order to help hedge against the risks associated with congestion pricing under an LMP model. The Commission reiterates that these CRRs are not a perfect hedge and that they are not required to be a perfect hedge under section 217 of the FPA or the Final Rule.

68. Also, we reaffirm our finding that the risk borne by small LSEs is not proportionately greater than that borne by large LSEs, as the long-term CRR rules treat all LSEs alike.[64] Furthermore, no evidence has been presented that demonstrates that a small LSE is proportionally faced with greater risk than a large LSE, as all LSEs face similar challenges when requesting CRRs.

69. The Commission disagrees with NCPA's assertion that the CAISO's long-term CRR proposal must be considered as a whole, because the Commission retains control over its dockets and may exercise its discretion to consider the components of the CAISO's proposal separately. We note that the Commission has already addressed NCPA's concern regarding credit collateral requirements in Docket Nos. ER07-1077-000, ER07-1077-001 and ER07-613-004. In that proceeding, the Commission granted "NCPA's request to direct the CAISO to limit estimated aggregate liability for long-term CRRs to only the current year's estimated liability."[65] Therefore, in response to NCPA's concern raised in the instant filing that excessive collateral requirements could be put to better use in building new transmission or generation resources, the Commission finds that its prior action appropriately addresses NCPA's concerns.

70. Also in Docket No. ER07-1077-000, the Commission addressed NCPA's concern regarding the delay in knowing the collateral requirements and NCPA's request to return

---

[63] *See infra* P 90 n.88.

[64] *See* July 6 Order, 120 FERC ¶ 61,023 at P 168.

[65] *See Cal. Indep. Sys. Operator Corp*. 120 FERC ¶ 61,192, at P 39 (2007) (Credit Collateral Order). The Commission explained that the annual auction is insufficient basis for calculating a credit obligation commensurate with a 10-year right. *Id.*

20080728-3036 FERC PDF (Unofficial) 07/28/2008

CRRs requiring collateral deposits.[66] The Commission responded to NCPA's request by stating that it "would compromise the CAISO's CRR allocation process and impose costs on a system the Commission has already approved as just and reasonable."[67] We are not persuaded otherwise in the instant proceeding, and we disagree that a small delay in knowing the collateral requirements is problematic.

c. External LSEs' Access to Long-Term CRRs

71. In its filing, the CAISO proposed to allocate CRRs to external LSEs. In response to SoCal Edison's comments, the CAISO proposed applying the forward-looking showing of need to serve load to all CRR nominations by external LSEs, including wheel-through CRR nominations, in conjunction with the rules for demonstrating eligible quantities of load for CRR allocation in accordance with proposed MRTU Tariff section 36.9.3.

72. In the July 6 Order, the Commission noted that the Final Rule Rehearing Order determined that an LSE is entitled to priority in the allocation of LTTRs where the transmission organization plans and constructs its transmission system to support the LSE's needs and the LSE contributes to these costs.[68] By extension of this principle, the Commission concluded that entities serving load located outside the relevant transmission organization may be eligible for allocation of LTTRs, provided they pay a share of the embedded costs of the transmission organization's transmission system. Because the Final Rule is a rulemaking of general applicability, the Commission declined to draw a broad conclusion that it may never be reasonable to treat external and internal load differently in allocating LTTRs.[69]

73. The Commission recognized, in the July 6 Order, the concerns raised by both the CAISO and protestors that these CRR nominations must be tied to the congestion charges that external LSEs actually incur when serving their load. The Commission also recognized that import capacity and the ability to hedge congestion costs at interties are critically important to internal LSEs. The Commission stated that, as discussed in prior orders,[70] the allocation of CRRs is intended to provide LSEs with a means to hedge

[66] *See id.* P 42.

[67] *Id*.

[68] July 6 Order, 120 FERC ¶ 61,023 at P 186 (citing Final Rule Rehearing Order, 117 FERC ¶ 61,201 at P 78).

[69] *Id.* (citing Final Rule Rehearing Order, 117 FERC ¶ 61,201 at P 81).

[70] *Id.* P 189 (citing *e.g.*, MRTU Order, 116 FERC ¶ 61,274 at P 704).

congestion costs incurred while using the CAISO transmission system to serve their load. Furthermore, the Commission noted that external LSEs are situated differently than internal LSEs because external LSEs may have the option of not using the CAISO transmission system.[71] The Commission found that the inability to verify on-going usage of the transmission system could result in the allocation of wheel-through CRRs to external entities that no longer use the CAISO transmission system to serve their load, which is inconsistent with allocating CRRs to LSEs to hedge the actual congestion costs they incur on the CAISO system. Accordingly, the Commission found that the CAISO's proposal to apply the forward-looking showing to all CRR nominations in conjunction with MRTU Tariff section 36.9.3 to be just and reasonable.[72] The Commission directed the CAISO to make a compliance filing revising MRTU Tariff section 36.9.1 accordingly. The Commission also noted that "all CRR nominations" now include not only short-term CRRs associated with wheel-through transactions but also long-term CRRs associated with wheel-through transactions. Therefore, the Commission stated that, as set forth in MRTU Tariff section 36.9.1, an external LSE's eligibility to nominate wheel-through CRRs will be subject to a forward-looking showing of need to serve load.[73]

74. On rehearing, Imperial claims that the Commission erred by allowing the CAISO to discriminate against external LSEs in violation of both the FPA and Commerce Clause. Imperial further asserts that the Commission's application of the forward-looking showing of need requirement to external LSEs and not internal LSEs, constitutes unlawful discrimination. Imperial argues that because the Commission is concerned that CRRs be used to hedge congestion cost to serve load, any forward-looking showing of need to serve load should be applied equally to external and internal LSEs. Imperial adds that imposing the forward-looking showing of need requirement on external LSEs is not necessary because they are prepaying the wheeling access charge. Imperial requests that either the Commission require all LSEs to make a reasonable showing that they have an ongoing need for CRRs to serve load or eliminate the uneven requirement imposed on external LSEs.

75. Imperial also claims that imposing the forward-looking showing of need requirement on only external LSEs could discourage them from building transmission. Specifically, Imperial asserts that if an external LSE can only show that it has an ongoing need for CRRs by entering into long-term power purchase and potentially transmission

---

[71] *Id*. (citing MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 679).

[72] *Id*.

[73] *Id*.

agreements, it will not be able to self-build transmission and generation.[74] Imperial contends that external LSEs that are financially obligated under long-term contracts may not be able to justify engaging in generation and transmission projects that take, for instance three to five years to build, because even if they were to self-build a transmission project, they would still be locked into the 10-year contract or incur a termination penalty in order to prematurely end the contract. Imperial suggests that external LSEs may be encouraged to self-build transmission and generation outside of the CAISO if both external and internal LSEs are required to prove the need for CRRs to serve load 120 days in advance of the allocation of the next batch of CRRs. Imperial argues that this approach would allow external LSEs to enter into one-year power purchase agreements, and, then, if the LSE is able to self-build transmission and generation, it could release the CRRs back to the CAISO or trade them in the secondary market.

Commission Determination

76. The Commission rejects Imperial's claims that (1) the CAISO's proposal allows it to discriminate against external LSEs in violation of the FPA and the Commerce Clause, and (2) the forward looking need requirement, imposed on external LSEs, lacks reasonable limitations on the proof required and deters self-build options in a manner that is contrary to both the intent of Congress and the Commission's policies.[75] We find that simply prepaying the wheeling access charge does not demonstrate that the external LSEs are actually subject to congestion charges related to their use of the CAISO's transmission system, and therefore does not further the intent underlying the CRR allocation process. Instead, this payment only serves as a contribution to the embedded cost of the transmission system, which is an underlying requirement to participate in the allocation process, but is not sufficient to ensure that external LSEs should be allocated valuable CRRs. In addition to this payment, external LSEs must demonstrate that they are actually using the CAISO transmission system to serve their load. Based on these interests, we approved the forward-looking showing of need requirement that is applied to all external LSEs' CRR nominations.

---

[74] Imperial points to proposed language in the CAISO's July 20, 2007 compliance filing that states that external LSEs must demonstrate that all of their long-term CRRs are supported by "a combination of long-term procurement arrangements of [10] years or greater and ownership of generation resources." Imperial August 6, 2007 Rehearing Request at 6 (quoting proposed MRTU Tariff section 36.8.3.1.3.2).

[75] The Commission has found that the inability to verify on-going usage of the transmission system could result in the allocation of CRRs to external entities that no longer use the CAISO's transmission system to serve their load, which is inconsistent with allocating CRRs to LSEs to hedge the actual congestion costs they incur. July 6 Order, 120 FERC ¶ 61,023 at P 189.

77. Moreover, we disagree with Imperial that requiring external LSEs to demonstrate a long-term forward need discourages the building of transmission. If an external LSE does not intend to use the CAISO's transmission system for the duration of an allocated long-term CRR, the external LSE should not be allocated a long-term hedge against congestion costs incurred on the CAISO's transmission system. Further, the CRR release process provides external LSEs with short-term supply arrangements the opportunity to request short-term CRRs on a similar basis as internal LSEs. Because, both external and internal LSEs face similar challenges when renewing short-term CRRs, we disagree with Imperial that providing external LSEs with the opportunity to request either short-term or long-term CRRs based on their supply arrangements somehow discourages transmission investment. Furthermore, if Imperial or another LSE anticipates building transmission and discontinuing its use of the CAISO's system, the Commission-approved CRR release process accommodates such prospective considerations.

78. Finally, because external LSEs are not necessarily dependent on the system and have been determined to not be similarly situated with internal LSEs, we do not agree that the imposition of the forward-looking determination of need on external LSEs results in unlawful discrimination and find that this requirement promotes the goal that CRRs be allocated to hedge congestion costs to serve load. For these reasons, we deny Imperial's request for clarification and/or rehearing.

2. Guideline 6

> [An LTTR] held by a [LSE] to support a service obligation should be re-assignable to another entity that acquires that service obligation.

79. Guideline 6 is intended to comply with section 217(b)(3)(A) of the FPA which requires transmission rights be transferable to successors ensuring that they follow migrating load. The Final Rule provides transmission organizations and stakeholders flexibility to determine the specific rules governing the reassignment of firm transmission rights due to load migration. The Final Rule states that this reassignment issue relates to transmission rights that are allocated preferentially to an LSE in accordance with Guideline 5 and not to rights acquired by an LSE via auction or direct assignment of funding an upgrade.[76] Guideline 6 also states that it allows for the trading of transmission rights.

---

[76] Final Rule, FERC Stats. & Regs. ¶ 31,226 at P 357.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

Reassignment of Long-Term CRRs Due to Load Migration

80. The CAISO's proposal retained the MRTU rules that require CRRs to follow the load in the case of load migration.[77] The CAISO stated that the proposal adhered to the basic principle that CRRs are assigned to LSEs as custodians for the load they serve.[78]

81. In the July 6 Order, the Commission disagreed with PG&E's proposal to reassign long-term CRRs. The Commission noted that, in the MRTU Order, it conditionally-accepted tariff provisions implementing mid-year CRR adjustments due to load migration and the CAISO's proposal to base these mid-year adjustments on the overall value of the load-losing LSE's CRR holdings. The Commission found that PG&E's proposal to transfer specific long-term CRRs was inconsistent with the value-based transfer (i.e., a pro rata share of all allocated long-term CRRs) conditionally accepted by the Commission. The Commission found that the value based transfer was a reasonable mechanism to ensure that load-gaining LSEs are appropriately compensated.[79] The Commission was not persuaded by the argument that long-term CRRs should be transferred in a different manner.

82. On rehearing, PG&E argues that the Commission's decision is contrary to FPA section 217(b)(3)(A), which provides that the load-gaining LSE is only entitled to LTTRs that are associated with the transferred service obligation. PG&E contends that the pro rata allocation does not ensure that the reassigned long-term CRRs are associated with the transferred load, as required by the FPA and asserts that the pro rata allocation may produce the opposite result.

83. PG&E contends that the Commission misunderstood its proposal and states that it was not asserting "that a load-gaining LSE was not entitled to the valu*e* of its pro rata portion of [long-term CRRs]."[80] Rather, PG&E explains that its argument was that "the load-gaining LSE was not entitled to an automatic pro rata portion of all [long-term CRRs] held by the load-losing LSE."[81] PG&E states that, consistent with FPA section 217(b)(3)(A), it proposed that the Commission direct the CAISO to develop, "a process by which reassigned [long-term CRRs] are associated with the departing load (i.e., the

---

[77] July 6 Order, 120 FERC ¶ 61,023 at P 200.

[78] *Id*.

[79] *Id.* P 211.

[80] PG&E August 2, 2007 Rehearing Request at 5.

[81] *Id*.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

load-gaining LSE's sources and sinks)."[82] PG&E argues that any reassignment process should include a determination of the value of reassigned long-term CRRs and make sure that value reflects the pro rata value of the load-losing LSE's total long-term CRRs. PG&E claims that the development of a long-term CRRs reassignment process would address the Commission's concern that reassigned long-term CRRs be sourced at a location that would result in the load-gaining LSE obtaining an appropriate hedge against congestion costs actually incurred.

84. PG&E argues that because the initial allocation of long-term CRRs has not occurred and the CAISO has not submitted evidence that it has tried to develop valuation methods for long-term CRRs, the Commission should, at a minimum, require the CAISO to try to develop valuation approaches through a stakeholder process before defaulting to an automatic pro rata allocation.

85. PG&E also claims that an automatic pro rata reassignment of long-term CRRs is unjust and unreasonable because it may mean that load-gaining LSEs receive long-term CRRs that they do not want or need, while load-losing LSEs are deprived of long-term CRRs that they need for the long-term supply arrangements they retain for existing customers. PG&E asserts that the Commission's desire to ensure that load-gaining LSEs receive a pro rata portion of the value of a load-losing LSE's long-term CRRs can be achieved while also taking into account both LSEs' sources and sinks. PG&E also discusses that there is potential for considerable load changes in California due to the possible re-opening of direct access and the formation of community choice aggregators.[83]

86. PG&E alleges that, contrary to FPA section 222, the CAISO's proposal may result in market manipulation and gaming. PG&E explains that because a load-gaining LSE may obtain long-term CRRs for a source from which it does not receive any supply, it will be in a position to manipulate the price at which it is willing to sell or trade the long-term CRRs to an LSE that receives supply from the source. To avoid this result, PG&E argues that long-term CRRs should be related to the LSEs' sources and sinks.

<u>Commission Determination</u>

87. We deny PG&E's request for rehearing and find that the CAISO's proposal is consistent with the requirements established in the Final Rule. An underlying principle

---

[82] *Id*.

[83] PG&E explains that California law allows municipal entities to form community choice aggregators, which are intended to provide electric supply to existing utility customers, replacing utility service. *Id*. at 7.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

of the CRR allocation process is that LSEs are awarded CRRs on behalf of their customers who pay the embedded cost of the transmission system. Consistent with this principle, the CAISO's proposal includes provisions detailing the reassignment of CRRs upon the migration of load. We again find the CAISO's proposal to reassign CRRs to be a reasonable approach that will not disadvantage either the load-gaining or the load-losing LSE. Further, we disagree that the CAISO's proposal is contrary to the FPA.

88. The Commission rejects PG&E's assertion that it misunderstood PG&E's comments. In the July 6 Order, the Commission recognized the importance of load-gaining LSEs receiving appropriate compensation.[84] If load-gaining LSEs are under compensated, they will not be able to compete for customers on an equal basis with load-losing LSEs that were directly allocated CRRs. The CAISO's proposal to transfer a proportionate share of the value associated with all the CRRs allocated to the load-losing LSE avoids this problem. PG&E argues that the CAISO should not automatically default to a pro rata reassignment of all CRRs. However, we find that by using the filed approach, load-gaining LSEs are ensured adequate compensation for migrating load. Further, we find that the difficultly in implementing PG&E's request outweighs any possible benefit. Accordingly, we will not direct the CAISO to initiate a stakeholder process to evaluate PG&E's requested modifications.

3. Miscellaneous Issues

a. Alternative Designs for LTTRs: Options v. Obligations

89. In its filing, the CAISO proposed that long-term CRRs, like the short-term CRRs conditionally accepted by the Commission, be obligation CRRs. In the Final Rule, the Commission did not preclude alternative designs for LTTRs, including departures from existing market designs. In the July 6 Order, the Commission discussed that one such design issue concerns the specification of LTTRs as options. The Commission stated that an obligation right is modeled with the counterflow of all other rights, while an option right is not. As a result, the Commission found that an obligation right requires the holder to pay LMP price differences if the prices at the source point(s) in the transmission right are higher than those at the sink point(s).[85] The Commission explained that an option right does not carry this obligation. The Commission stated that if the holder of the obligation right can follow the schedule implied in its transmission right (i.e., the MWs injected and withdrawn), then it will collect in negative congestion charges (i.e., payments from the Regional Transmission Organization, RTO) what it owes in CRR

[84] *See* July 6 Order, 120 FERC ¶ 61,023 at P 211.

[85] *Id.* P 223.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

obligation payments. Moreover, the Commission found that in most transmission networks, the modeling of counterflows greatly increases the quantity of transmission rights that are simultaneously feasible.[86]

90. In the July 6 Order, the Commission found that obligation long-term CRRs satisfied the Final Rule. In the Final Rule, the Commission did not preclude alternative designs for LTTRs, including both obligations and options, but rather, it explored the implications for market efficiency and equity that flow from each type of right. The Commission noted that while obligation CRRs may result in a negative payment stream to the CRR holder, they also tend to make more CRRs available to market participants than option CRRs.[87] Furthermore, the Commission added that it had found that the allocation of LTTR option rights would present equity problems in most organized electricity markets. The Commission determined that each approach had well known advantages and disadvantages; therefore, a hearing was not necessary because it would not add value to the record on this issue. The Commission also rejected concerns regarding the need to provide physical rights.[88] The Commission further noted that, under the CAISO's proposal, the availability of seasonal and time-of-use CRRs helps to reduce the potential for obligation payments, and added that a party submitting a physical schedule that matches its obligation CRR will face little risk of negative payments. Accordingly, the Commission found that the CAISO's proposal continued to be just and reasonable.

91. On rehearing, SMUD argues that the Commission's response that neither the FPA nor Order No. 890 requires ISOs to offer physical rights service misconstrues its concerns. Specifically, SMUD asks "if no option CRRs are offered by CAISO, are the financial rights in the form of obligation CRRs equivalent to physical rights?"[89] SMUD

---

[86] *Id.*

[87] *Id.* P 226 (citing Final Rule, FERC Stats. & Regs. ¶ 31,226 at P 475; MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 405).

[88] *See id.* The Commission responded to these concerns in the July 6 Order by finding that financial rights can be the equivalent of physical rights and that the CAISO's LTTR provisions, as modified by the Commission, will provide LTTRs that are financial but are sufficiently firm to constitute the equivalent of physical rights. *See id.* P 240-52. In the MRTU Rehearing Order, the Commission pointed out that it had previously accepted the CAISO's proposal to allocate obligation CRRs. *Id*. P 226 (citing MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 405 (citing *Cal. Indep. Sys. Operator Corp.*, 105 FERC ¶ 61,140, at P 177 (2003)).

[89] SMUD August 6, 2007 Rehearing Request at 3.

points out that changes in flow patterns can turn obligation CRRs from congestion hedges into payment obligations. SMUD claims that the Commission's response that obligation CRRs tend to make more CRRs available does not meet the statutory requirement that financial rights be equivalent to physical rights. Additionally, SMUD complains that the Commission has not explained why customers should not be afforded the right to purchase either option or obligation CRRs. Absent that right, SMUD contends that there "are no firm transactions that are hedged against congestion charges because all of those hedges can become obligations."[90] SMUD argues that, by approving the CAISO's proposal, the Commission has endorsed converting a hedge against risk into an instrument for assuming risk. According to SMUD, such a result will render the long-term firm transmission rights offered by the CAISO inferior to the long-term firm rights available under Order No. 890. SMUD claims that this result is contrary to the requirement in Order No. 890 that the CAISO meet the "as good as or superior to" standard.[91]

<u>Commission Determination</u>

92. We deny SMUD's request for rehearing regarding the CAISO's proposal to utilize obligation CRRs rather than option CRRs. SMUD poses the question of, "if no option CRRs are offered by the CAISO, are the financial rights in the form of obligation CRRs equivalent to physical rights?"[92] The Commission has found that financial rights in the form of obligation long-term CRRs are equivalent to physical rights.[93] The Commission's conclusion did not hinge on obligation CRRs being utilized in combination with option CRRs. As such, the Commission is not requiring that the

---

[90] *Id*.

[91] *Id*. at 4 (citing Order No. 890 at P 157).

[92] *Id*. at 3.

[93] *See* July 6 Order, 120 FERC ¶ 61,023 at P 243 n.164 (discussing, Final Rule, FERC Stats. & Regs. ¶ 31,226 at P 170, 473-74 ("[U]nder our guidelines financial rights are as firm as physical rights [are] outside organized electricity markets[.]"). *Id*. P 173; *see also Midwest Indep. Trans. Sys. Operator, Inc.*, 109 FERC ¶ 61,157, at P 140 (2004) (finding that "all parties in the [Midwest Independent Transmission System Operator, Inc.] markets will receive sufficient [financial transmission rights] to hedge congestion charges such that net congestion charges will be comparable with the costs of redispatch and costs of curtailments due to [transmission loading line relief] associated with their existing transmission service"); *Pacific Gas & Elec., et al*., 80 FERC ¶ 61,128, at 61,427 & n.40 (1997) (requiring CAISO to file LTTR plan but allowing the CAISO to chose physical and/or financial rights)).

CAISO develop an option CRR. Furthermore, the Commission has not discussed, as SMUD states, "why customers should not be given the right to purchase either option or obligation CRRs"[94] because the CAISO's proposal utilizing obligation long-term CRRs was found to satisfy the Final Rule. Consequently, the Commission need not reach the merits of option long-term CRRs in this proceeding. Moreover, we reiterate our finding that the allocation of LTTR option rights would present equity problems in most organized electricity markets.[95] At best, if all eligible parties requested option rights rather than obligation rights, the set of allocated CRRs would be greatly reduced.

93. The Commission disagrees with SMUD's contention that, absent a customer's right to purchase either option or obligation CRRs, there "are no firm transactions that are hedged against congestion charges because all of those hedges can become obligations."[96] We have previously found that the CAISO's proposal to utilize obligation CRRs complies with the Final Rule.[97] Additionally, we have stated that the CAISO's long-term CRR instrument "provides a firmness that is equivalent or superior to that of a physical rights product."[98]

94. We reject SMUD's assertion that, by approving the CAISO's obligation long-term CRRs proposal, the Commission has endorsed converting a hedge against risk into an instrument for assuming risk. A party that submits a physical schedule matching its obligation CRR should face little risk of negative payments. For these reasons, we find that obligation long-term CRRs are instruments that hedge against risk, rather than instruments that assume risk.

b. Exemption of Long-Term CRRs from Marginal Losses

95. In the July 6 Order, the Commission denied SMUD's requested marginal loss hedge because in the Final Rule the Commission determined that transmission organizations are not required to provide marginal loss hedges.[99] The Commission stated

---

[94] SMUD August 6, 2007 Rehearing Request at 3.

[95] July 6 Order, 120 FERC ¶ 61,023 at P 226 (citing Final Rule, FERC Stats. & Regs. ¶ 31,226 at P 475).

[96] *See* SMUD August 6, 2007 Rehearing Request at 3.

[97] July 6 Order, 120 FERC ¶ 61,023 at P 226.

[98] *Id*. P 248

[99] *Id.* P 229 (citing Final Rule, FERC Stats. & Regs. ¶ 31,226 at P 478; Final Rule Rehearing Order, 117 FERC ¶ 61,201, at P 105-06).

20080728-3036 FERC PDF (Unofficial) 07/28/2008

that, EPAct 2005 does not require a marginal loss hedge. The Commission further explained that, due to the nature of marginal losses, it is much more difficult to design a hedge for marginal losses than it is to create one for congestion costs.[100] Consequently, while theoretically possible, to date no one has designed a workable marginal loss hedge, so no transmission organization has been able to implement one. The Commission found that it would be unreasonable to direct the CAISO to provide a mechanism that is not required. The Commission noted that it had reached the same conclusion in the MRTU proceeding, and the Commission reaffirmed that conclusion in the July 6 Order.[101] Notwithstanding this determination, the Commission continued to encourage the CAISO to explore methods by which it can assist LSEs and others to obtain a hedge for marginal losses.

96. On rehearing, SMUD claims that the Commission misconstrued its argument. SMUD states that its objection is not that the EPAct 2005 per se required a marginal loss hedge.[102] Rather, SMUD states that its objection is that, without a marginal loss hedge, the financial rights offered in the CAISO's proposal will not be equivalent to the physical rights available under the Order No. 890 OATT. SMUD is concerned that the use of marginal losses, like congestion charges, creates unhedged risks. SMUD claims that, "even with congestion hedges financial firm rights would remain inferior to physical rights firm service under the *pro forma* OATT, contrary to the Energy Policy Act."[103] SMUD argues that the Commission's response that it has permitted transmission organizations to employ marginal losses does not address its argument. SMUD relies on the Commission's statement that to date no one has designed a workable marginal loss hedge to support its assertion that the resulting services are not equivalent to the physical rights services. SMUD claims that the Commission's insistence that customers accept these risks is an unexplained departure from its recognition that customers should enjoy at least a transition period in which the exposure to these currently unhedgable charges will be mitigated by refunding them the difference between their marginal losses and average losses.[104]

[100] *Id.* (citing Final Rule Rehearing Order, 117 FERC ¶ 61,201 at P 105).

[101] *Id*. (citing MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 446 (finding that the lack of a marginal loss hedge does not render the MRTU Tariff unjust and unreasonable)).

[102] SMUD August 6, 2007 Rehearing Request at 4.

[103] *Id*.

[104] *Id*. at 5.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

97. SMUD provides that, in response to its concern that the CAISO's customers will be exposed to marginal losses rather than the predictable average losses in a physical rights arrangement, the Commission stated that customers would be eligible for refunds of the marginal loss surplus collected by the CAISO, which would lessen the impact of the marginal loss charges.

98. SMUD claims that the Commission's response is unclear. According to SMUD, if the Commission is suggesting that a refund mechanism like the one adopted in the Midwest ISO, which refunded overcollections based on the difference between marginal losses charges and average losses, may be adopted and would alleviate SMUD's concerns, then the Commission should make this clarification.[105] SMUD also adds that the Commission's statement that "it remains to be seen whether the financial outcome is substantially different from paying average loss charges" undermines the basis for using marginal losses.[106] SMUD contends that, "to the extent the Commission has thereby expressed a willingness to permit that outcome, its determination constitutes a tacit acknowledgement that a regime of unhedgable marginal loss exposure is inferior to the physical rights regime called for in Order No. 890."[107]

99. SMUD requests that, until the CAISO develops a marginal loss hedge, the Commission direct it to adopt a Midwest ISO-like transition mechanism, which would permit market participants to receive refunds so that they would not pay more than their average losses.

Commission Determination

100. The Commission denies SMUD's rehearing request that the CAISO be required to develop a transition mechanism that would allow market participants to receive refunds so that they would not pay more than their average losses. As the Commission has previously noted, the benefits of using marginal losses are well-documented,[108] and we

[105] *Id.* However, SMUD contends that the Commission has previously stated that such a refund mechanism would undermine the purpose of the marginal loss regime's price signal concept. *Id.* at 5-6.

[106] *Id*. at 6.

[107] *Id*.

[108] *Midwest Indep. Trans. Sys. Operator, Inc.*,102 FERC ¶ 61,196, at P 53 (*MISO*), *order on reh'g,* 103 FERC ¶ 61,210, at P 28-29 (2003); *Central Hudson Gas & Elec. Corp*., 86 FERC ¶ 61,062 (*Central Hudson*), *order on reh'g*, 88 FERC ¶ 61,138, at 61,384-85 (1999); *New England Power Pool*, 100 FERC ¶ 61,287 (*NEPOOL*), *order on*

(continued…)

20080728-3036 FERC PDF (Unofficial) 07/28/2008

have approved similar marginal loss provisions for the Midwest ISO, the New York ISO, and ISO New England, Inc., ISO New England.[109] The Commission reiterates its finding that the CAISO's proposal to reflect marginal losses in its calculation of LMPs is appropriate because this approach sends more accurate signals and assures least-cost dispatch.[110] Furthermore, the Commission reaffirms its findings that while it is economically desirable for customers to be able to hedge uncertain costs, the ability to hedge all costs is not a prerequisite for just and reasonable rates.[111] We also reiterate that the benefits of marginal losses outweigh the perceived difficulties in hedging them.[112]

101. The Commission has previously recognized that the implementation of marginal loss provisions should not be dependent on the resolution of accounting procedures.[113] However, a method must be established for disbursing the over-collected amounts. The Commission has found that, since the price customers are paying (based on marginal losses) is the correct marginal cost for the energy they are purchasing, customers are not entitled to receive any particular amounts through disbursement of the over-collections.[114] The Commission has made clear that the method for disbursing over-collections should not directly reimburse customers for their marginal loss payments, because such a reimbursement would both interfere with the goal that prices be based on marginal losses and undermine price signals to investors and load. The Commission accepted the CAISO's proposed allocation of over-collections because it allowed participants to pay

---

reh'g, 101 FERC ¶ 61,344 (2002); *Northeast Util. Serv. Co.*, 105 FERC ¶ 61,122, at P 18-20 (2003) (*Northeast Utils.*), *reh'g denied*, 109 FERC ¶ 61,204 (2004); *Atlantic City Elec. Co. v. PJM Interconnection, L.L.C.*, 115 FERC ¶ 61,132, at P 4 (2006) (*Atlantic*).

[109] *MISO*, 102 FERC ¶ 61,196 at P 53, 56; *Central Hudson*, 86 FERC ¶ 61,062 at 61,213-14; *NEPOOL*, 100 FERC ¶ 61,287 at P 64, 71; *Northeast Utils.*, 105 FERC ¶ 61,122 at P 18-20.

[110] MRTU Rehearing Order, 119 FERC ¶ 61,076 at P 37 (citing MRTU Order, 116 FERC ¶ 61,274 at P 90-2).

[111] *Id*. P 42.

[112] *Id.*

[113] *See MISO*, 102 FERC ¶ 61,196 at P 54 (2003) ("we do not believe that the lack of a specific crediting mechanism represents an impediment to relying upon marginal losses, nor do we believe that it is a reason for using a less efficient pricing mechanism, such as average losses").

[114] *Atlantic*, 115 FERC ¶ 61,132 at P 24.

20080728-3036 FERC PDF (Unofficial) 07/28/2008

the marginal cost of energy.[115] For these reasons, we deny SMUD's rehearing request. Additionally, we will not require the CAISO to develop a hedging mechanism for marginal losses.[116]

The Commission orders:

(A) The requests for rehearing of the July 6 Order are hereby denied, as discussed in the body of this order.

(B) The requests for clarification of the July 6 Order are hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

[115] MRTU Order, 116 FERC ¶ 61,274 at P 95.

[116] The Commission notes that no other RTO or ISO has been able to develop a hedging mechanism for marginal losses because hedging mechanisms for marginal losses are in the experimental stage.

Document Content(s)