COMMENTS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON THE WESTERN AREA POWER ADMINISTRATION, SIERRA NEVADA REGION'S RESOURCE ADEQUACY PLANS

I. Introduction

The California Independent System Operator Corporation ("CAISO") appreciates the opportunity to comment on the resource adequacy plans developed and published by the Western Area Power Administration, Sierra Nevada Region ("WAPA") (72 Fed. Reg. 20528 (April 25, 2007) ("RA Plans"). The CAISO also appreciates the efforts of WAPA staff to engage CAISO and arrange the public meeting held on May 16, 2007 to discuss the RA Plans. Through this effort, a greater understanding of the interests and objectives of all affected parties was achieved. In this regard, the CAISO believes the public meeting exposed several fundamental misconceptions held by WAPA regarding the CAISO's resource adequacy provisions under its Market Redesign and Technology Upgrade ("MRTU") tariff provisions.[1]

These misconceptions and their potential impact on the RA Plans are further discussed below. The CAISO recommends WAPA reassess the RA Plans in light of the MRTU Tariff, rather than the soon to expire Interim Reliability Requirements Tariff, and make those revisions necessary to ensure that the requirements in the MRTU Tariff can be the satisfied. It is likely that these changes to the previously published RA Plans will be material. If so, the CAISO believes it is appropriate to allow for additional public review and comment prior to final adoption by WAPA.

II. Comments

The CAISO is charged under both California law and by FERC with the responsibility for the reliable operation of the transmission system under its Operational Control. RA is a necessary element that allows the CAISO to meet this mandate. As the CAISO noted at the May 16th meeting, under California's capacity-based RA programs, there are several elements, including forecasts of Demand, establishment of planning reserve margins ("PRM"), resource counting conventions, and locational requirements, that are warranted under Good Utility Practice and enable capacity to be made available where and when needed to satisfy reliability requirements. When properly designed, these elements also provide the basis to ensure that the responsibility for RA among market participants is equitably allocated. Indeed, FERC has recognized that it is impermissible for one LSE to "lean on" other LSEs to the detriment of their customers and grid reliability as a whole and, therefore, "each LSE within the CAISO-controlled

[1] The RA Plans note WAPA's dispute as to the applicability of the CAISO's RA tariff provisions. While the CAISO acknowledges WAPA's position, for purposes of these comments, the CAISO presumes WAPA is subject to CAISO tariff provisions in accordance with orders of the Federal Energy Regulatory Commission ("FERC"). (See, *Cal. Indep. Sys. Operator Corp.*, 116 FERC ¶ 61,274 (Sept. 21, 2006) ("September Order"); *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,076 (April 20, 2007) ("April Order").) In this regard, the CAISO's comments reflect application of the CAISO's MRTU Tariff, rather than the expiring Interim Reliability Requirements Tariff.

grid [must] maintain adequate resources." (September Order at P 1116.) Achieving this FERC requirement should help guide revisions WAPA contemplates to its RA Plans.

A. Election of LSE Status

The CAISO offers two program options for LSEs, which are not Load Following Metered Subsystems, to satisfy their RA-related MRTU Tariff obligations. [PDP-I think we can leave this point. Do we also want to add that this ensure they are not "leaning" on other LSEs?]The first option is the "Reserve Sharing LSE" alternative. The second is the "Modified Reserve Sharing LSE" option. The Reserve Sharing LSE option mirrors, and is intended to work in coordination with, the CPUC's RA program. The Modified Reserve Sharing option was designed to provide LSEs an alternative approach to fulfilling their RA requirements. In either case, the Scheduling Coordinator ("SC") for the LSE must communicate the election to the CAISO on behalf of the LSE. WAPA must, therefore, determine the nature of its relationship with its customers, i.e., is WAPA the SC, LSE and/or LRA for each customer? If only an SC, the election authority resides with the underlying LSE/LRA. The CAISO is willing to cooperate with WAPA and its participants to determine appropriate classifications.

The CAISO does not intend to provide an exhaustive description of the two options. (See Exhibit J – Testimony of Mark Rothleder in ER06-615-000 (Feb. 2006).) However, the CAISO emphasizes that the Modified Reserve Sharing LSE option requires that the LSE have direct "visibility" of the resources offered to satisfy its daily RA obligation, either as the SC for the resource or through some other direct communication arrangement with the resource owner. The reason for this need arises from the presence of a potential "capacity surcharge" to be assigned to a Modified Reserve Sharing LSE that fails to replace unavailable capacity within an hour plus the next HASP scheduling opportunity. (See MRTU Tariff Sections 40.5.1 and 40.5.4.)

B. Demand Forecast

The election status of an LSE/LRA affects the applicable Demand Forecast methodologies that can be employed. Because Modified Reserve Sharing LSEs are allowed to offer resources at a level that follows their load, rather than against a monthly peak that dictates a Reserve Sharing LSEs obligation, LSEs that elect that option must provide Demand Forecasts based on non-coincident peaks. In contrast, since LSEs that elect Reserve Sharing LSE status have explicitly chosen to contribute to, and rely on, a "pool" of capacity to meet reliability needs, the MRTU Tariff provides Demand Forecast options. Those options are to utilize a non-coincident peak developed by the LSE or a coincident peak Demand Forecast developed by the California Energy Commission ("CEC"). In the April Order, FERC "agree[d] with the CAISO that coincident peak demand determinations should be made by one entity and that the [CEC] is best situated to provide this service." (April Order at P 638.) Only if the CEC is unable to provide a coincident peak Demand Forecast for a particular LSE may that LSE seek a coincident peak Demand Forecast from the CAISO. It is our understanding that WAPA intends to base its RA program on a coincident peak demand. Accordingly, the CAISO urges

WAPA to contact the CEC and submit the necessary load data to permit compliance with these provisions of the MRTU Tariff.

C. Planning Reserve Margin

WAPA's RA Plans propose to establish a peak seasonal PRM of 10% and an off-peak seasonal PRM of 5%. The discussion at May 16th meeting indicated that WAPA misunderstood the underpinnings of the PRM because these stated values did not incorporate the expected provision of required operating reserves. For instance, the CPUC derived its 15-17% PRM to account for (1) the LSE's Demand, (2) the LSE's proportionate share of operating reserves, (3) generator forced outages, and (4) intrinsic forecast error, i.e., economic activity underestimated. Accordingly, given these underpinnings, WAPA's proposed PRMs are unlikely to be adequate to avoid potential undue reliance on the capacity provided to the CAISO by other LSEs.

WAPA, or the LRAs it serves, has the authority to determine its PRM. The CAISO would request that WAPA consider PRM(s) that fully incorporate, at a minimum, for the above-described factors and that it fully explain the development of the revised PRM(s).

D. Counting Conventions

At the May 16th meeting, there was considerable discussion regarding Firm Liquidated Damages ("LD") contracts. Firm LD contracts must be distinguished from import arrangements that demonstrate that the energy or capacity is provided by a resource external to the CAISO Control Area. Instead, Firm LD contracts are those that deliver energy within the CAISO Control Area, but do not identify the specific unit or resource supporting the arrangement. Such suppliers can, therefore, elect to rely on the CAISO spot market for energy to meet its contractual Firm LD obligations, subject solely to its individual risk tolerance. Nevertheless, in deference to the historic role of LRA's over procurement practices of their LSEs, the CAISO MRTU Tariff provides LRA's with flexibility to define the resources that will qualify for satisfying the RA requirements imposed on its LSE, including Firm LD contracts.

Firm LD contracts remain a necessary and effective tool for LSEs to hedge energy cost risks. However, the CAISO has consistently and repeatedly denounced the use of such contracts for RA compliance purposes. These types of contracts are incompatible with a capacity-based RA paradigm given concerns about deliverability and the possibility of double-counting of resources. The CPUC has decided to phase-out Firm LD contracts from RA eligibility based on these very tangible concerns. Given the CPUC phase-out, there is a very real likelihood that non-CPUC Load Serving Entities that continue to utilize Firm LD contracts for RA requirements will increasingly receive the benefits of capacity payments made by other LSEs. This outcome is contrary to FERC's objective that LSEs not "lean" on others. WAPA should similarly develop a reasonable schedule to phase-out its reliance on Firm LD contracts.

E. Import Allocation

The RA Plans demonstrate a high degree of reliance on resources imported into the CAISO Control Area and in particular the Central Valley Project ("CVP") hydroelectric facilities located in the SMUD control area. On May 18, 2007, FERC accepted the CAISO's revised methodology to assign available import capacity for RA purposes.[2] Under that proposal, a hierarchy of assignment priorities is created. First, import capability associated with Existing Transmission Contracts are reserved for the holders of such rights. Second, the CAISO assigns Pre-RA Import Commitments, which are any power purchase agreement, ownership interest, or other commercial arrangement entered into on or before March 10, 2006, by an LSE serving Load in the CAISO Control Area for Energy or capacity from a resource(s) located outside the CAISO Control Area. Because, by definition, virtually all Pre-RA Import Commitments participated in the assignment process for 2007 and were accommodated, the CAISO does not anticipate that a branch group will be over requested during this step in the assignment process. The CVP would appear to fall within the definition of Pre-RA Import Commitments entitled to assignment priority. The CAISO has not presently performed an analysis to ensure that, in fact, WAPA's imports will be accommodated. In this regard, to the extent Pre-RA Import Commitments must be reassigned because a particular branch group is over-requested, the available capability will be assigned according to the respective load ratios of those LSEs making the requests.

FERC also accepted the CAISO's proposal to "cap" the further assignment of aggregated Available Import Capability to an LSE at the greater of the sum of the import capability received as Existing Contract Capacity, i.e., ETCs, and Pre-RA Import Commitment Capacity or the LSE's Load Share Quantity.[3] Thus, if WAPA's Pre-RA Import Commitment Capacity exceeds its Load Share Quantity, it would not be eligible to receive any additional aggregated Available Import Capacity. This would mean that WAPA's ability to meet load growth through greater reliance on increased imports or recently executed import contracts may be limited absent obtaining additional import capability through the secondary market. WAPA therefore should carefully review the import deliverability section of the MRTU Tariff in formulating its revised RA Plans.

F. Local Capacity Requirements

It became apparent at the May 16th meeting that WAPA misunderstands the scope of an LSEs' obligations regarding local capacity under the MRTU Tariff. In the September Order, FERC found the CAISO to be "uniquely situated to assess capacity needs in constrained areas" and assigned the CAISO responsibility to "perform an annual technical study to determine the minimum amount of capacity that must be available to the CAISO within each local capacity area." (September Order at P 1119.) The CAISO will assign each LSE with proportionate responsibility for local capacity as follows:

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[2] *Cal. Indep. Sys. Operator Corp.*, 119 FERC ¶ 61,164 (May 18, 2007).

[3] Please see CAISO's filing of March 22, 2007 in FERC Docket No. ER07-648-000 for a complete list of relevant definitions.

> The responsibility for the aggregate Local Capacity Area Resources for all Local Capacity Areas within each TAC Area will be allocated to all Scheduling Coordinators for Load Serving Entities that serve Load in the TAC Area in accordance with the Load Serving Entity's proportionate coincident share, on a gross Load basis, of the previous annual peak Demand in the TAC Area under conditions used in the technical study.

Accordingly, it is not the LSE's share of load in each Local Area that determines its obligation, but rather its proportionate share of load in the TAC Area. In other words, all of WAPA's Demand in the service territory of PG&E will count toward determining its responsibility for local capacity in all of the Local Areas within PG&E's service territory. However, the CAISO intends to modify the allocation methodology by replacing the use of historical data with each LSE's contribution to the CAISO's forecasted coincident peak Demand as determined by the CEC. This better conforms to the role played by CEC Demand forecast information in the overall RA program.

Once the entities' assigned responsibility is established, the CAISO does not obligate the LSE to procure local capacity. This decision is made by the LSE and/or Local Regulatory Authority. However, after analyzing the aggregate portfolio of local capacity procured by LSEs, should the CAISO require additional local capacity to satisfy the reliability requirements underlying the technical study, the CAISO will assign the costs of such procurement first to those LSEs that did not demonstrate procure up to the amount assigned by the CAISO.

III. Conclusion

The CAISO reiterates its appreciation for this opportunity to provide input into WAPA's RA Plans. The CAISO is encouraged that WAPA will revise its RA Plans to better conform to the provisions of the CAISO MRTU Tariff and reflect its proportionate responsibility to maintain adequate resources to promote continued grid reliability.

Please coordinate questions concerning this letter through you account manager Keoni Almeida at 916.608.1121.