
FEDERAL ENERGY REGULATORY COMMISSION



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NEWS RELEASE

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and ER02-1656-024

COMMISSION CONDITIONALLY ACCEPTS CAISO MARKET REDESIGN, ORDERS SYSTEMS TO BE TESTED, READY BEFORE IMPLEMENTATION

The Federal Energy Regulatory Commission today conditionally accepted the California Independent System Operator's (CAISO) Market Redesign and Technology Upgrade (MRTU) proposal, concluding that the tariff reforms will bring important corrections and improvements to the CAISO markets necessary to enhance reliability of the grid, protect customers from market manipulation, and to promote infrastructure development.

Many of the MRTU tariff revisions address known market-design flaws, including those that contributed to the California energy crisis of 2000-2001. These flaws impede the ability of the CAISO to reliably deliver low-cost energy and unnecessarily restrict customers from access to supplies of choice, including long-term supplies.

The Commission conditionally accepted the CAISO's proposal, directing significant changes in the MRTU tariff to address concerns raised by commenters, and requires technical conferences to address, among other things, concerns about operational rules that differ between the CAISO and providers of transmission service in the West outside of California, commonly referred to as "seams" issues.

"California's market redesign is the product of more than six years of analysis, stakeholder input, coordination with state authorities and Commission guidance. The purpose of the MRTU order is clear: to prevent a recurrence of the California and Western power crisis from 2000-2001. Once in place, MRTU will do that by helping to provide adequate electricity supply in California, by fixing market rules flaws, and by guarding against market manipulation," Chairman Joseph T. Kelliher observed.

"So today, by fixing many of the inherent flaws in California's market design that contributed to the 2000-2001 Western energy crisis, we take important steps to address remaining shortcomings in California's existing market structure and protect Western

consumers against a repeat of the energy crisis. And by enhancing system reliability and improving market power mitigation, we create an environment more conducive to investment in sorely needed energy infrastructure in California and throughout the West,” Chairman Kelliher said.

Today’s 400-page order responds to the CAISO’s 8,000-page filing and the numerous and lengthy comments filed by market participants both inside and outside California, pertaining to the various elements of the proposed market design. The Commission conditioned its acceptance in numerous areas and noted that CAISO must submit a number of compliance filings. The Commission also ordered three technical conferences to address specific MRTU elements.

“Although these reforms are significant, it is important to keep in mind that the changes are incremental and supplement the existing market structure,” the Commission said, calling the redesigned market an important step in promoting the development of effectively competitive markets that will bring benefits to power customers.

The Commission, in setting November 1, 2007, as the effective date for implementing the new market design, emphasized that it is “strongly committed to a sound and orderly MRTU implementation plan and will not allow that to be sacrificed for the sake of expedience.” The Commission ordered protections to ensure that systems are tested and ready before they are implemented.

With today’s order, the Commission addressed three of the key factors that contributed to the California and Western energy crisis of 2000-2001: the lack of adequate resources, flawed market rules, and market manipulation.

Significant components of the MRTU Tariff approved today include:

- a more effective system for managing congestion;
- a financially-binding day-ahead market;
- system improvements that will increase operational efficiency and enhance reliability;
- a more transparent pricing system;
- improved market power mitigation measures;
- the opportunity for demand response resources to participate in the ISO markets; and
- a process that respects the resource adequacy requirements established by the California Public Utilities Commission and other Local Regulatory Authorities, with provisions to allow the CAISO to procure additional capacity if needed.

The following are among the significant changes that the Commission ordered to the CAISO's MRTU proposal:

- To address the jurisdictional concerns raised by some parties, the Commission rejected the CAISO's proposal to apply a 15 percent generating reserve requirement to all load-serving entities (LSEs) that serve load in the CAISO Control Area. Instead, for LSEs not subject to the jurisdiction of the California Public Utilities Commission, the Commission allows the 15 percent requirement to be applied only as a default if that LSE in California fails to identify its reserve requirement.
- The Commission rejected the CAISO's request for an exception or delay in complying with the Long-Term Firm Transmission Rights Final Rule, and directs it to comply with that Final Rule in order to expedite the provision of long-term transmission rights to users of the grid

The Commission also required that the CAISO certify to the Commission at least 60 days prior to MRTU implementation that the software and markets will work as expected.

The existing CAISO market was implemented in April 1998. As early as January 2000, the Commission had determined that the CAISO's method of managing congestion contained a serious flaw, which was later considered a contributing factor in the energy crisis of 2000-2001. In December 2001, the Commission directed the CAISO to create a new day-ahead market along with a revised congestion management plan. Since that time, numerous Commission orders provided further guidance to the CAISO in developing its proposed market design.

The Commission approved market power mitigation measures in the MRTU proposal, including continued bid caps on energy and ancillary services, and improved measures to protect against the exercise of market power in discrete areas where insufficient competitive generation exists.

California's existing market design ignores large areas of transmission congestion until the last minute (or "real time"), and as a result allows buyers and sellers to submit schedules that cannot be accommodated on the transmission system. In contrast, the MRTU will use a locational pricing system and computer modeling of the grid that identifies constraints as early as the day ahead so that the CAISO can adjust scheduling accordingly.

With the new design, the CAISO will be able to identify transmission bottlenecks ahead of time, better allocate use of transmission facilities and make more efficient use of transmission and generation resources to serve load, and provide system reserves on a

least-cost basis. This system will provide the system operator and market participants with detailed price information and help determine locations for development of needed generation and transmission facilities.

A system of locational prices will reflect the market price of what power is worth at various locations given the physical limitations of the transmission system. Increased transparency in real-time prices and congestion costs should provide better information on market-driven locational siting alternatives for investment in generation and transmission, the Commission said. However, the Commission asked for more detail on locational pricing and directed the CAISO to supplement its tariff filing within 30 days.

In addition to addressing tariff language for elements approved in prior Commission orders, today's order also addressed issues not previously before the Commission in concept. The order directed three technical conferences to be convened to address the allocation of resource adequacy import capacity, Business Practice Manuals and the so-called seams issues.

The Commission also directed the parties interested in further developing demand response in the CAISO markets to provide proposals to the Commission that detail new avenues for incorporating price-responsive demand in MRTU.

Among other things, the Commission order directs the CAISO to:

- comply with the Commission's Long-Term Firm Transmission Rights Final Rule;
- report quarterly on meetings with neighboring control areas on seams issues;
- file quarterly performance reports once MRTU is implemented;
- implement reserve shortage scarcity pricing within 12 months of the November 1, 2007, initial MRTU implementation; and
- develop and implement interim measures to counteract incentives for Load Serving Entities to underschedule (this measure is to remain in place until convergence bidding is implemented).

In a separate order (ER02-1656-024), the Commission today accepted a CAISO compliance filing and "perfect hedge" proposal, designed to provide financial protection to existing transmission contracts holders against any congestion charges that may arise under the locational pricing in the proposed MRTU tariff.