

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell and Joseph T. Kelliher.

California Independent System Operator  
Corporation

Docket No. ER02-1656-025

ORDER ON CONCEPTUAL PROPOSAL ESTABLISHING SETTLEMENT  
SERVICES FOR INTER-SCHEDULING COORDINATOR TRADES

(Issued June 10, 2005)

1. In this order, we approve in principle the California Independent System Operator Corporation's (CAISO's) conceptual proposal to establish settlement services for bilateral energy transactions at generation nodes within the CAISO control area and at aggregated pricing points. The settlement service at individual generation nodes will be subject to a physical validation procedure under which a Scheduling Coordinator must demonstrate that it has a physical resource scheduled at the same generation node at a level not less than the amount of the trade. The proposal is designed to address issues surrounding the seller's choice contracts under the CAISO's Locational Marginal Pricing (LMP)-based market redesign.<sup>1</sup>

2. This order benefits customers by offering a settlement service for bilateral contracts, which will address seller's choice contracts and will remove a potential obstacle to the timely implementation of the CAISO's Market Redesign and Technology Upgrade (Market Redesign).<sup>2</sup>

**Background**

3. In January 2000, the Commission found that the CAISO's congestion management method was fundamentally flawed, and directed it to design a comprehensive replacement congestion management approach.<sup>3</sup> The CAISO began a stakeholder

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<sup>1</sup> A seller's choice contract allows a seller of power to designate the point of delivery on the CAISO's system.

<sup>2</sup> Formerly referred to as the CAISO's Comprehensive Market Design 2002 (MD02).

<sup>3</sup> *California Independent System Operator Corporation*, 90 FERC ¶ 61,006, *reh'g denied*, 91 FERC ¶ 61,026 (2000).

process to do this, but the subsequent upheaval in the CAISO power markets in 2000 and 2001 delayed the CAISO's efforts. The Commission then directed the CAISO to propose a plan by May 1, 2002, to implement a day-ahead market, to be integrated with the revised congestion management plan that was directed in January 2000.<sup>4</sup> The CAISO then filed its Market Redesign proposal. The Commission issued an order accepting in part, rejecting in part, and directing modifications to the CAISO's Market Redesign proposal.<sup>5</sup>

4. In July 2003, the CAISO filed a revised conceptual proposal to develop design elements of its prior proposal. In response, the Commission issued a guidance order<sup>6</sup> approving, in principle, many of the conceptual design elements submitted by the CAISO. One of the issues discussed in the *Guidance Order* was the concern raised by the California Energy Scheduling Division (CERS) of the California Department of Water Resources (CDWR) relating to the possible effect of the CAISO's proposed Market Redesign on its long-term bilateral contracts. Specifically, the CERS raised concerns that the implementation of an LMP-based market design would undermine the long-term contracts entered into by the CERS on behalf of retail customers during the 2000-2001 energy crisis.

5. In a June 17, 2004 Order,<sup>7</sup> the Commission instituted a Federal Power Act (FPA) section 206 proceeding before an administrative law judge (ALJ)<sup>8</sup> to investigate the feasibility of upholding the CERS contracts without modification, while implementing the CAISO's proposed Market Redesign, including the degree to which these types of contracts create market inefficiencies and are not operationally and economically compatible with the CAISO's proposed Market Redesign, and the options for resolving issues surrounding the seller's choice contracts.<sup>9</sup>

6. During the course of the section 206 proceeding, settlement judge procedures were established to provide a forum for parties to renegotiate the terms of their sellers' choice contracts. The settlement judge procedures resulted in two uncontested offers of settlement being filed by CERS and two settlements in principle being reached between

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<sup>4</sup> *San Diego Gas & Electric Company*, 97 FERC ¶ 61,275 at 62,245 (2001).

<sup>5</sup> *California Independent System Operator Corporation*, 100 FERC ¶ 61,060 (2002).

<sup>6</sup> *California Independent System Operator Corporation*, 105 FERC ¶ 61,140 (2003) (*Guidance Order*).

<sup>7</sup> *California Independent System Operator Corporation*, 107 FERC ¶ 61,274 (2004) (June 17 Order).

<sup>8</sup> See Docket No. EL04-108-000.

<sup>9</sup> See June 17 Order at P 166.

CERS and its counter-parties.<sup>10</sup> These offers of settlement are based upon Commission approval of the CAISO's physical validation procedure (described below) , without modification.<sup>11</sup>

7. On March 15, 2005, the CAISO filed its Inter-Scheduling Coordinator Trade Proposal (Inter-SC Trade Proposal). The CAISO states that the purpose of the instant conceptual proposal is to solicit the Commission's guidance on whether the components of the Inter-SC Trade Proposal are acceptable so that the CAISO can proceed with: (1) the development of the software and systems required to implement this aspect of its Market Redesign and (2) the preparation of detailed tariff sheet amendments. The CAISO also states that the Proposal will resolve issues surrounding the seller's choice contracts in the Market Redesign.

8. The CAISO's Proposal describes the services that the CAISO will provide with respect to the settlement of Inter-SC Trades of energy under its proposed Market Redesign. The instant proposal also includes a description of Existing Zone Generation Hubs (EZ Gen Hubs) which will replace existing congestion zones with contract delivery points under the CAISO's LMP-based Market Redesign. In its filing, the CAISO states that the instant proposal is the work product of an extensive stakeholder process and that it should be generally acceptable to market participants.<sup>12</sup>

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<sup>10</sup> On April 11, 2005, the Chief Judge suspended the procedural schedule until further Commission action. Subsequently, the Commission issued an order providing clarification on the scope of the section 206 proceeding and granting motions to dismiss contracts from the proceeding. Consistent with this clarification, the Commission dismissed all contracts which were not listed in Attachment B to the June 17 Order. *See California Independent System Operator Corporation* 111 FERC ¶ 61,138 (2005).

<sup>11</sup> Concurrent with this order, the Commission is approving two separate offers of settlement in Docket Nos. EL04-108-003 and EL04-108-004.

<sup>12</sup> Prior to submitting the Inter-SC Trade Proposal for Commission review, the CAISO initiated a market participant process by soliciting comments on a November 19, 2004 white paper. On December 9, 2004, the CAISO hosted a stakeholder meeting to review the white paper proposal and requested and received numerous written comments. The CAISO hosted a second stakeholder meeting on January 11, 2005, in which significant modifications were made to the Proposal in response to stakeholder feedback. The CAISO Governing Board approved the Proposal on January 27, 2005 and authorized this filing.

### **The CAISO's Inter-SC Trade Proposal**

9. Currently, the CAISO operates only a real-time market for energy and each Scheduling Coordinator must submit to the CAISO a balanced schedule of load and generation. Inter-SC Trades are used to allow Scheduling Coordinators to balance their portfolios through bilateral trades with other Scheduling Coordinators.<sup>13</sup> Under its Market Redesign, the CAISO is introducing a forward energy market and eliminating the balanced schedule requirement and Scheduling Coordinators will be able to come into the forward market with unbalanced portfolios and bids to purchase and sell energy. With the introduction of a forward energy market, Inter-SC Trades are no longer needed to balance schedules and, therefore, are no longer a required element under the CAISO proposed Market Redesign. However, in order to facilitate resolution of the concerns regarding the compatibility of existing seller's choice contracts with Market Redesign, the CAISO is proposing to offer Inter-SC Trade settlement as an optional service as part of its Market Redesign.

10. The CAISO explains that Inter-SC Trades under its Market Redesign would facilitate the settlement of bilateral energy contracts because: (1) contracting parties will be able to use the Inter-SC Trade as the instrument for the contractual delivery of energy; (2) the Inter-SC Trade will provide a counter settlement mechanism to reverse the payment that occurs by virtue of forward bilateral schedules being settled through the CAISO markets;<sup>14</sup> and (3) it will allocate congestion costs for contractual delivery between the two counter-parties.

11. The CAISO's Inter-SC Trade Proposal introduces settlement services for bilateral energy transactions at generation nodes within the CAISO control area and at aggregated

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<sup>13</sup> For instance a scheduling coordinator that has a portfolio of load and generation that is short on generation can balance itself by doing an Inter SC Trade with another scheduling coordinator that has a portfolio that is long in generation. By entering into the trade, both scheduling coordinators meet the requirement of balanced schedules.

<sup>14</sup> In order to determine and allocate congestion costs under a forward energy market, it is necessary to settle all schedules in the market at the market clearing prices, even those associated with bilateral transactions. Settling these bilateral transactions at the market clearing prices creates a situation where the buyer pays twice and the seller is paid twice. The CAISO states that it is proposing this Inter-SC Trade settlement service as a means of counter-settling the double payments. It is important to note that the Inter-SC trades do not affect the bilateral contract price. The counter-parties to the Inter- SC Trade will need to settle the bilateral contract price on their own.

pricing points (trading hubs and load aggregation points).<sup>15</sup> These Inter-SC Trade settlement services will be provided in both the day-ahead market and the hour-ahead scheduling process or hour-ahead market, should the CAISO implement a full settlement hour-ahead market.<sup>16</sup>

12. The CAISO states that although the existing CERS contracts must be settled through the Inter-SC Trade mechanism in order to resolve the seller's choice issues associated with these contracts, other parties to bilateral contracts (existing or new) are free to settle their contracts without using this service. The CAISO states that the Inter-SC Trade Proposal affords market participants an option for the settlement of bilateral contracts.<sup>17</sup>

### **Inter SC-Trades at Generation Nodes (Physical Validation Procedure)**

13. As part of the CAISO's Proposal, Inter-SC Trades at individual generation nodes will be subject to a Physical Validation Procedure<sup>18</sup> prior to and after the forward energy market clears. Trading Scheduling Coordinators must demonstrate (either directly or through an Inter-SC Trade with another supplier) that their trade is supported by a transmission feasible generator resource scheduled at the same generation node that has capacity that is equal to, or greater than, the amount of the trade.

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<sup>15</sup> Consistent with today's market design, the CAISO will not be offering Inter-SC Trades at intertie scheduling points.

<sup>16</sup> Inter-SC Trades submitted for the day-ahead market will be settled at day-ahead market prices; Inter-SC Trades submitted in the hour-ahead scheduling process will be settled at real time prices.

<sup>17</sup> Although the CAISO's proposal does not limit market participants' ability to enter into bilateral power contracts with whatever settlement provisions they desire, it dictates that if they choose to use the CAISO Inter-SC Trade mechanism for settling their contracts, the trades will be settled by the CAISO in accordance with its Inter-SC Trade rules.

<sup>18</sup> According to the CAISO requiring Physical Validation of Inter-SC Trades at generation nodes limits the volume of contractual sales settled at any node to the physical capabilities of the grid at that node and in so doing increases the likelihood that load will obtain sufficient CRRs to hedge the congestion costs associated with this contractual delivery.

14. The Physical Validation Procedure includes a pre-market and post-market validating process. According to the CAISO, prior to market clearing, individual trades that exceed a resource's capacity will not be validated by the CAISO and will be sent back to the Scheduling Coordinator. Additionally, if a series of linked trades drawing on a single resource are individually valid but collectively exceed the resource's schedule or offered quantity, each of the Inter-SC Trades relying on the oversubscribed resource will be reduced on a pro-rata basis until the Inter-SC Trades are valid.<sup>19</sup>

15. The volume of the Inter-SC Trades that pass the pre-market validation process may be reduced after the forward market clears if the generation unit supporting the Inter-SC Trade has a final market schedule that is below the quantity of Inter-SC Trades at that location. The megawatt quantities of the Inter-SC Trades that are adjusted down during this post-market validation process will be converted to trades at the EZ Gen Hub price (as discussed below) of the existing congestion zone containing the generator.<sup>20</sup> The portion of the Inter-SC Trade that remains will be settled at the LMP for the selected generation node.

### **Inter-SC Trades at Aggregated Pricing Points**

16. Although the CAISO is proposing to offer Inter-SC Trade settlement services for bilateral energy transactions at aggregated pricing points (trading hubs and load aggregation points), Inter-SC Trades at aggregated pricing points will not be subject to the Physical Validation Procedure.<sup>21</sup> Instead, these trades will be subject to a simpler pre-market validation and will involve confirming that both parties agree on the quantity and location of the trade.

17. The CAISO also proposes to provide EZ Gen Hubs as successor delivery points under LMP for today's existing internal congestion zones (NP15, SP15, and ZP26). Under the Proposal, the EZ Gen Hub prices will represent the average price paid to

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<sup>19</sup> The portions by which these trades are reduced are not part of the settlement service provided by the CAISO in this Proposal.

<sup>20</sup> According to the CAISO, settling the curtailed portion of these Inter-SC trades at the EZ Gen Hub Price is appropriate because it represents the best proxy price for the "market cost" of serving the contract.

<sup>21</sup> Inter-SC Trade mechanism at trading hubs and load aggregation points (without the need to provide physical validation) is similar to the zonal-Inter-SC Trade mechanism currently available. That mechanism validates physical delivery on a system aggregated basis.

generation within the zone and will be based on only LMPs at generation nodes. The CAISO states that the precise weighting factors used to calculate the EZ Generation Hubs has yet to be determined and will be deferred for further stakeholder input and study.

18. The CAISO has also identified several unresolved issues raised by market participants. These issues include: (1) the CAISO's credit and collateral policies for Inter-SC Trades, (2) the CAISO's proposed treatment of Existing Transmission Contracts (ETCs) under the Market Redesign,<sup>22</sup> and (3) the additional functionality for Inter-SC trades of ancillary service obligations consistent with the current Market Redesign proposal. The CAISO states that these issues will be addressed in the future, but their resolution will not affect the Inter-SC Trade Proposal.

19. According to the CAISO, Commission approval of the Inter-SC Trade Proposal and the creation of EZ Gen Hubs will facilitate resolution of the issues pertaining to the CERS contracts under Market Redesign. The CAISO states that the settlements among the CERS and other market participants were negotiated in reliance on the Proposal and are contingent on the Commission's approval of this Proposal without modification. The CAISO further states that any modification to the Proposal will likely undo some of the settlement agreements between CERS and its counter-parties.

### **Notice, Motions to Intervene, and Responsive Pleadings**

20. Notice of the CAISO's filing was published in the *Federal Register*, 70 Fed. Reg. 16,813 (2005), with comments, protests, or interventions due on April 12, 2005. Coral Power, L.L.C., Sempra Generation (Sempra), and Sacramento Municipal Utility District (SMUD)<sup>23</sup> filed motions to intervene. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the filing of a timely motion to intervene that has not been opposed makes the movant a party to the proceeding.

21. The CAISO and Sempra filed answers to protests. SMUD filed an answer to the CAISO's answer to protests. Rule 213(a) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a) (2004), prohibits answers to protests and answers unless otherwise permitted by the decisional authority. We will accept CAISO's answer to protests because its answer has assisted in our decision-making. However, we are not persuaded to allow Sempra's answer to protests and SMUD's answer to the CAISO's answer to protests.

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<sup>22</sup> The CAISO states that if the Inter-SC Trade software is used to facilitate the settlement of ETC schedules, the CAISO will need to provide ETC holders with some additional bilateral settlement options as reflected under the terms of their ETCs.

<sup>23</sup> SMUD became a party to this proceeding by virtue of submitting a timely motion to intervene in Docket No. ER02-1656-015. See *Guidance Order* at P 18 and Attachment.

22. Many commenters express strong support for the Inter-SC Trade Proposal. The California Public Utilities Commission (CPUC), California Electricity Oversight Board (CEOB), CDWR's State Water Project (SWP), CERS, and Sempra filed comments in support of the Proposal. The CEOB states that the CAISO, with input from market participants, has created a solution that allows for resolution of the LMP issues created by seller's choice contracts while providing a simple, useful service consistent with the proposed Market Redesign. The CPUC and CERS state that the Proposal represents an equitable compromise for all participants in the CAISO's redesigned day-ahead markets and will provide a commercial solution to address seller's choice contract issues without limiting the flexibility of market participants to engage in future financial transactions. The CAISO, CERS, CEOB, CPUC and Sempra strongly urge the Commission to accept the Proposal without modification, because certain settlements between CERS and its counterparties are conditioned upon the Commission's acceptance of the Inter-SC Trade Proposal without modification or conditions unacceptable to either party.<sup>24</sup>

23. Certain protesters, however, oppose the CAISO's proposal and urge the Commission to reject it. Certain parties argue that the CAISO's filing is incomplete and should be rejected or the Commission should defer action on the Proposal until all deficiencies have been resolved, *e.g.*, lack of tariff language, no precise weighting factors. Additionally, protesters raised other issues including Inter-SC Trades for ancillary services, creditworthiness requirements, CRR allocation, and treatment of ETCs.

24. In particular, SMUD argues, among other things, that the Inter-SC Trade Proposal will introduce a new settlement process under the Market Redesign in which every transaction must be settled through the CAISO and, therefore, the Proposal is not voluntary. SMUD asserts that this requirement to settle contracts through the CAISO will create price uncertainty and risk for participants who have existing bilateral contracts. SMUD also challenges the CAISO's decision not to offer the Inter-SC Trade counter-settlement to trades at interties and contends that this restriction could decrease the quantity of imports. Finally, SMUD states that the Inter-SC Trade Proposal exposes parties who have entered into bilateral agreements several risks: credit risks associated with potentially unhedgeable congestion charges; additional unhedgeable costs stemming from marginal losses already factored into existing bilateral agreements; and their ability to enter into contracts with renewable energy resources.

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<sup>24</sup> CERS states that Sempra, Calpine Energy Services, L.P., and Power Contract Financing, L.L.C., which account for approximately 3,600 MWs of energy to be delivered daily to CERS through year 2009, have agreed to resolve the seller's choice issues in their respective long-term contracts by adopting the physical validation provisions proposed in the Inter-SC Trade Proposal. *See* CERS comments at 1-2.

25. In its reply comments, the CAISO states that the purpose of the filing is to solicit the Commission guidance and to ensure that the key elements of the Proposal are supported by the Commission before the CAISO undertakes the effort of developing software to implement the settlement service for Inter-SC Trades. The CAISO states that even if the Inter-SC Trade Proposal is approved without modification, the CAISO will not implement it until the tariff language is reviewed and approved by the Commission.

26. In response to SMUD's concerns, the CAISO states that the requirement that parties settle their forward energy purchases through the CAISO is a consequence of the adoption of an LMP-based forward market and not a result of this filing. CAISO asserts that only market participants, who have voluntarily chosen to settle their bilateral transactions using the CAISO's settlement services, will be required to abide by the CAISO Inter-SC Trade rules. The CAISO also offers that settlement of Inter-SC Trades at interties is unnecessary for two reasons. First, if the buyer agrees to pay potential congestion charges, there is no need for the counter-settlement process, since the buyer will schedule the import, be credited for its supply at the intertie price, and will be charged for its load at the load aggregation point price. Second, if the seller agrees to pay potential congestion charges, the seller will schedule the import and then schedule an Inter-SC Trade with the buyer, which will be settled at the buyer's Load Aggregation Point price.

27. With respect to issues raised by SVP, TANC and Roseville concerning CRRs, compatibility of the Inter-SC Proposal with ETCs, Inter-SC for ancillary services and credit issues, CAISO states that these are separate market design issues and acknowledges that any overlap pertains to software issues. The CAISO reaffirms its commitment to work with stakeholders to resolve these issues regarding credit and collateral policies and reiterates that this issue can be considered and resolved separately from the Proposal.

### **Commission Determination**

28. We approve, in principle, the CAISO's Inter-SC Trade Proposal, including the Physical Validation Process and the proposed creation of EZ Gen Hubs as successor delivery points under LMP for the CAISO's existing internal congestion zones.<sup>25</sup> We believe that the Inter-SC Trade Proposal, including the creation of EZ Gen Hubs, is a reasonable means to resolve the issues arising under seller's choice contracts and the transition of these contracts to LMP. The Inter-SC Trade settlement service may also be used by other parties for the settlement of their bilateral contracts. Contrary to assertions raised by SMUD, the Inter-SC Trade settlement service is voluntary; it affords market

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<sup>25</sup> We note that the creation of EZ Gen Hubs based on the current congestion zones should not preclude the CAISO from creating additional hubs under LMP.

participants an option to settle bilateral contracts using the service; however, market participants can establish different settlement provisions if they so choose. Other issues raised by market participants are addressed below.

29. We note that the filing is a conceptual proposal through which the CAISO seeks the Commission's guidance prior to incurring costs for the development of the software necessary for the implementation of the Inter-SC Trade settlement service and the preparation of detailed tariff sheet amendments. Our acceptance of the Proposal, in principle, will further facilitate the implementation of the CAISO's Market Redesign on its current schedule and allow the CAISO to resolve issues surrounding the seller's choice contracts. For this reason, we deny the requests to reject the CAISO's proposal as incomplete or deficient, as well as SMUD's request to set the instant conceptual proposal for an evidentiary type hearing. However, at the time the CAISO submits for Commission review further details of this conceptual proposal, including the precise duration of the Final Trading Period and the corresponding tariff language, market participants may raise further issues, as necessary.

30. In regard to other issues identified by protesters, such as introduction of Inter-SC Trades for ancillary services, creditworthiness requirements, CRR allocation, and treatment of ETCs, we agree with the CAISO that these issues are separate from the instant proposal. We also note that the CAISO has committed to address these issues with market participants in the future. However, in regard to the issue of treatment of ETCs in connection with the instant proposal, we believe that to the extent congestion revenues are credited back to ETC rights holders using the Inter-SC Trade software, the CAISO should provide a full and complete explanation of that process upon the submission of tariff sheets implementing the Inter-SC Trade Proposal.

31. In regard to issues raised by SMUD regarding the settlement of Inter-SC Trades at the interties, we find that the CAISO's answer sufficiently addresses these concerns. However, with regard to SMUD's concern about the impact of the Proposal on its ability to contract for renewable energy, we find that SMUD failed to successfully articulate its concerns.

32. With regard to SMUD's argument that marginal losses applied to existing bilateral agreements may become an additional unhedgeable cost that contributes to price uncertainty, we find this issue to be outside the scope of this proceeding. We note that the CAISO's use of marginal losses in its Market Redesign was approved in the *Guidance Order*.<sup>26</sup>

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<sup>26</sup> See *Guidance Order* at P 77.

The Commission orders:

(A) Approval in principle is hereby granted for the CAISO's Inter-SC Trade Proposal; guidance is hereby provided, as discussed in the body of this order.

(B) SMUD's motion to reject the CAISO's Inter-SC Trade Proposal, or, alternatively, to set the matter for evidentiary hearing is denied.

By the Commission. Commissioner Kelly not participating.

( S E A L )

Magalie R. Salas,  
Secretary.