UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas and Electric Company) **Docket No. ER98-2785-000**

MOTION TO INTERVENE, MOTION TO CONSOLIDATE,
MOTION FOR SUMMARY DISPOSITION
AND PROTEST OF THE CALIFORNIA
INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rules 211 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211 and §385.214, the California Independent System Operator Corporation ("ISO"), hereby moves to intervene, submits this protest and asks that the Commission take the following action in the above captioned proceeding:

1) that the Commission consolidate this docket with the related section 205 rate proceedings for Reliability Must-Run (RMR) services at Duke Energy's (Duke's) newly-acquired Moss Landing and Oakland generating units, Docket Nos. ER98-2668-000 and Er98-2669-000, respectively; and

2) that the Commission summarily deny PG&E's request to terminate RMR service to the ISO, and order PG&E to continue providing service under its currently effective agreement, or in the alternative, that the Commission suspend the notice of termination for five months and order an expedited hearing on all issues in the consolidated proceedings.

I. SERVICE

The names and addresses of the persons to whom communications concerning this filing are to be addressed are as follows:

N. Beth Emery
Vice President and General Counsel
Roger Smith
Regulatory Cousel
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: 916-351-2334
Fax: 916-351-2350

Stephen Angle
Robert C. Fallon
Linda L. Walsh
Howrey & Simon
1299 Pennsylvania Ave., N.W.
Washington, D.C. 20004-2402
Tel: (202) 783-0800
Fax: (202) 383-6610

Brian Theaker
California Independent System
Operator Corporation
1000 S. Fremont A-13
Alhambra, CA 91802
Tel: 626-537-2746
Fax: 626-537-2350

Fiona Woolf
Bridget E. R. Shahan
Cameron McKenna LLP
2000 Pennsylvania Ave. N.W., Ste. 8550
Washington, D.C. 20006
Tel: 202-466-0060
Fax: 202-466-0077

II. DESCRIPTION OF THE PARTY

The ISO is a non-profit public benefit corporation organized and existing under the laws of the State of California, in which it is authorized to do business. On March 31, 1998, the ISO took control of and currently operates the transmission systems of Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE) and San Diego Gas and Electric Company (SDG&E). The ISO is responsible for maintaining the reliability of electric transmission scheduled into, out of, and through the ISO control area. To support reliability, the ISO is also responsible for procurement of ancillary services, to the extent that they are not self-provided, at a competitive price. The activities of the ISO are subject to the jurisdiction of the Commission.

III. MOTION TO INTERVENE

On April 30, 1998, PG&E filed a Notice of Termination of its Reliability Must-Run Rate Schedules (RMR Agreements) for the Moss Landing and Oakland Power

Plants. PG&E requested authorization to terminate these rate schedules as part of the transfer of the facilities to Duke Energy Moss Landing LLC and Duke Energy Oakland LLC (hereinafter referred to collectively as Duke), which proposes to operate the facilities under its own RMR Agreements. ER98-2668-000 and ER98-2669-000. Those proposed agreements were filed with the Commission on April 24, 1998, but have not yet been accepted or otherwise approved.[1]

As the other party to the RMR Agreements and the purchaser of the energy and ancillary services offered thereunder, the ISO has a direct and substantial interest in this proceeding. Moreover, the ISO's interests cannot be adequately represented by any other party. Accordingly, the ISO respectfully requests that it be permitted to intervene herein with full rights of a party.

IV. MOTION TO CONSOLIDATE THE INSTANT PROCEEDING WITH THE RELATED DUKE MUST-RUN PROCEEDING

To consummate its purchase of the two PG&E Must-Run units here at issue, Duke requested Commission approval of two completely new RMR Agreements for the two units, including new RMR rates. The fundamental issue in each of these dockets is whether PG&E has met the conditions under which it is allowed to convey RMR units to a new purchaser. Pursuant to the terms of PG&E's currently effective must-run agreements, PG&E can only terminate RMR service to the ISO upon sale of the facilities *if the purchaser agrees to provide service under substantially the same terms and conditions, including a cost-based rate.* Because PG&E's ability to terminate its must-run service to the ISO and, consequently, Duke's authority to file the successor RMR agreement are fundamentally intertwined, the dockets should be consolidated.

[1] The ISO objected to each of these filings in Protests and Motions filed on May 13, 1998 and May 14, 1998 in the relevant dockets. While the ISO indicated in those filings that it would attach a copies of those pleadings to the instant filing, the ISO has incorporated many of the same arguments herein. Accordingly, in order to avoid needless duplication, the ISO has not attached its prior substantive pleadings.

V. MOTION FOR SUMMARY DISPOSITION AND PROTEST

Consistent with its request to reject Duke's proposed RMR Agreements, the ISO requests that the Commission summarily deny PG&E's proposed termination of its must-run service to the ISO, and require PG&E to continue to provide service under the currently effective agreement pending submission of a suitable replacement contract. In the alternative, the ISO requests that the Commission suspend PG&E's Notice of Termination for a five month period, pending a determination of the reasonableness of that termination and of the terms and conditions of service under which Duke will provide service.

Reliability Must-Run service is, in effect, a substitute transmission service. This Commission has already determined that owners of RMR units can exercise locational market power, and that generation at such units must accordingly be made available to the ISO at cost-based rates. *Pacific Gas & Elec. Co.*, 81 FERC ¶61,122 at 61,537 (1997). As a result, RMR arrangements are *sui generis* when compared to typical wholesale sales arrangements and the Commission's pronouncements in this matter will have broad ramifications not only in California, but elsewhere when the grid operator does not own or directly control generation.

The ISO understands that divestiture of generation is in the public interest and the ISO does not want to delay the divestiture of these units. However, the ISO urges the Commission to deny PG&E's request to terminate transmission service for the serious operational and financial reasons described below. This action does not leave PG&E and Duke without an opportunity to effectuate the divestiture. Like other purchasers of RMR units, Duke has the option of taking an assignment of PG&E's filed agrement, or of filing another agreement that will comport with the termination provision of PG&E's agreement.

PG&E's request to terminate service is not in the public interest under these circumstances, given the serious operational and financial implications if the ISO is required to purchase RMR service under the Duke proposal. Accordingly, under Section 203 of the Federal Power Act (FPA) and under the Commission's standard for allowing termination of service, the instant request must be denied.

Moreover, PG&E's notice of termination is inconsistent with the terms of the currently effective RMR Agreements for the two Must-Run units. That Agreement provides that PG&E may transfer the facility only to a purchaser willing to provide service under substantially the same terms and conditions. As detailed in this pleading, the Duke terms and conditions are materially different from those in the PG&E filed Agreement, and will seriously impair the ISO's ability to provide reliable electric transmission service. Moreover, the terms will impose substantial additional financial costs on the ISO, to the detriment of all California ratepayers. These facts are so self-evident that the Commission should reject PG&E's filing as a matter of law.

Should the Commission not grant summary disposition on the question of whether PG&E's termination pre-condition has been satisfied, however, (*i.e.*, the filing by a successor of a rate with substantially the same terms and conditions) then the Commission should suspend PG&E's termination notice for a full five months and set for expedited hearing the question of whether PG&E's requested termination is just and reasonable under the circumstances.

A. Background on PG&E's Provision of Reliability Must-Run Service

On October 31, 1997, PG&E filed fourteen RMR agreements to provide services to the ISO, including the provision of energy and ancillary services from the Duke Must-Run units. The services that PG&E provides to the ISO help to ensure that the ISO can operate the ISO Control Grid is a reliable manner. In early 1997, PG&E itself designated the Moss Landing and Oakland units as must-run units. In July 1997, the ISO Governing Board adopted PG&E's recommendation designating Moss Landing and Oakland as must run units. In late 1997, PG&E and Duke entered into an agreement by which PG&E agreed to sell three of its generating facilities to Duke. On April 24, 1998, Duke filed new RMR agreements and rate schedules for the Moss Landing and Oakland units, and on April 28, 1998 PG&E filed a Notice of Termination for RMR service from these units.

As the purchaser of RMR services from 117 separate units—services the ISO requires to maintain the reliability of the system—the ISO requires a uniform *pro forma* RMR agreement to ensure equity and ease in administration and consistency in cost determination. The word "uniform" does not imply that each RMR unit must have identical costs, identical performance characteristics and identical service limits. Given the large portfolio of RMR units under the ISO's control—117 hydro, geothermal, steam turbine and gas turbine units ranging in size from less than 1 MW to over 700 MW—the contracts cannot be literally the same. The RMR contract schedules are sufficiently detailed to allow for differences among units with respect to costs, performance characteristics and service limits. However, uniformity in the RMR context does mean that the costs, performance characteristics, service limits and obligations of both the RMR Owner and the ISO in all the contracts must be determined—and administered—in the same way.

B. Substantial Public Interest Issues Warrant the Commission's Scrutiny and Use of Conditioning Authority Under Section 203 of the Federal Power Act.

Important public interest considerations dictate that the Commission should require PG&E and its successor in interest, Duke, to file under Section 203 of the FPA for authority to transfer jurisdictional assets and demonstrate that, on balance, the proposed transfer is consistent with the public interest. Under Section 203 of the FPA any sale or lease of jurisdictional facilities valued in excess of $50,000 requires prior Commission approval. 16 U.S.C. §824(b)(a). Neither PG&E nor Duke have provided an explanation as to why they have not sought Section 203 approval for the proposed transfer of the Must-Run units[2], nor have they adequately demonstrated that they could meet the Section 203 public interest requirement for Commission approval thereof.

The Commission has well-established authority to treat the proposed transfer as subject to the requirements of Section 203. Section 201(b)(1) of the FPA sets out the parameters for determining whether facilities are FERC jurisdictional, and therefore whether prior approval of a transfer is required under Section 203. Jurisdictional facilities have long been interpreted to include generating facilities used in the provision of wholesale service, or otherwise used in sales of electricity that will enter a commingled supply, unless that supply is restricted to a single state. *See, e.g., Jersey Central Power & Light Co. v. Federal Power Commission*, 63 S.Ct. 953, 319 U.S. 61, 87 L.Ed. 1258 (1943); *Hartford Elec. Light Co. v. FPC*, 131 F.2d 953, (2d Cir. 1942), *cert. denied*, 319 U.S. 741 (1943).[3]

Energy from the Must-Run units is clearly being sold into a commingled supply of electricity, some of which is delivered in sales for resale in interstate commerce. Moreover, the generation supplied in this instance is so intertwined with the provision of reliable transmission service (and has even be described as substitute transmission service), that the Commission must exercise jurisdiction over the transfer to ensure the continued reliability of transmission – a function that is clearly within FERC's established realm of authority. *See Enova Corp. and Pacific Enterprises*, 79 FERC ¶ 61,107 (1997) (interpreting section 201(b)(1) broadly to apply to any transaction or corporate change that might tend to impede the coordination of jurisdictional facilities).

---

[2] The transfer is expected to be consummated on June 23, 1998.

[3] As was noted in *Hartford*, *supra* Section 201(b)(1)'s limitation on jurisdiction over generating facilities does not apply to facilities that contribute to wholesale interstate sales. 131 F.2d at 962.

Notably, parties in similar circumstances have affirmatively sought the Commission's approval of a proposed transfer. For example, the Commission recently approved a sale of generation and related transmission assets from New England Power Company and others to USGen New England, Inc. *New England Power Co.,* 82 FERC ¶ 61,179 (1988). In that order, the Commission carefully reviewed the effects that the transfer, part of the overall restructuring of the New England electric industry, would have on the public interest, including the effects on competitors' rates and regulation. No less is required by the transaction at issue in this proceeding. As a key component of the California restructuring with a significant potential effect on the reliability of future electric operations, this transaction requires full public interest scrutiny.

In particular, the locational criticality of Moss Landing cannot be overemphasized. Duiring some portions of the year, the Moss Landing facility must be operational and providing both energy and VAR support. Without this support, certain outages can cause voltage instability and possible collapse and potential area blackouts in parts of California's South Bay Area known as "Silicone Valley."

Under these circumstances, PG&E cannot meet its burden of showing that the proposed transfer is in the public interest. As is discussed more fully in section C, infra, PG&E seeks to terminate service to the ISO prior to the filing of an adequate replacement RMR Agreement, *i.e.,* one that provides for service under substantially similar terms and conditions as in the PG&E Agreement. These facilities are critically situated and by definition have market power under certain operating conditions. The ISO has no alternative but to call on these facilities during those conditions to ensure the reliable operation of the transmission system. Finally, as is discussed more fully in section E, PG&E's proposed termination of service will result in immediate financial harm to the ISO (and to California consumers). Given the substantial detriment to the ISO, California consumers, and reliable electric service, the Commission should not permit the transfer to occur under the conditions proposed.

C. PG&E Has Failed to Meet the Conditions Under Which the Must-Run Units May Be Conveyed Because Duke's Proposed Agreement is Not Substantially Similar to, Nor an Adequate Substitute for, PG&E's RMR Agreement.

The Commission should not permit PG&E to terminate service under its existing RMR Agreement because Duke's proposed substitute RMR Agreement does not contain substantially the same terms as PG&E's currently effective agreement—a condition precedent to the sale of RMR facilities. The PG&E RMR Agreements for the Moss Landing and Oakland facilities set forth the specific terms under which PG&E can terminate the agreement upon the purchase of facilities by another party. According to PG&E's RMR Agreement "A," section 2.2(a)(iii):

> This Agreement may be terminated by Owner, if it sells the Facility to a purchaser who, if ISO requires the Units to continue to be available, executes a contract with ISO or files a rate schedule with FERC to provide ISO the right to purchase Energy and Ancillary Services from the Unit under substantially the same terms as this Agreement (including terms specifying cost based rates, subject to the provisions of Section 5.7 of the Master Must Run Agreement). Such termination may not take effect prior to the effective date of all necessary regulatory approvals, including acceptance by FERC of the contract between ISO and the purchaser of the rate schedule filed by the purchaser.

Thus, the PG&E contract can be terminated only if the purchaser—Duke—provides a substitute agreement that allows the ISO to purchase energy and ancillary services under "substantially the same terms." Although PG&E acknowledges that the RMR Agreement sets forth this test, PG&E argues the test will be satisfied because "Duke will provide the same services under its RMR Agreements." However, this argument ignores the difference between the service being provided and the terms of that service.

A review of the Duke's proposed RMR Agreement reveals that it contains a number of terms that are not "substantially the same" as the PG&E Agreement, and would significantly prejudice the ISO. For example:

- Duke seeks a Letter of Credit from the ISO. (Section 8.5.) The ISO is prohibited from issuing this Letter of Credit by the Reimbursement Agreement in Article VII, Negative Covenants of the ISO, Section 7.2, Limitations on Additional Debt. Any breach of this covenant would be an event of default in the Reimbursement Agreement in Article VIII, Defaults and Remedies, Section 8.1c, Events of Default.

- Duke seeks the right to suspend service for non-payment. (Section 11.4.) There is no such right in the other RMR Agreements.

- Duke has changed the way "Owner's Deemed Costs" are calculated for the "B" contract.

- The definition of *force majeure* would excuse Duke from mechanical breakdowns. (Section 1.25.) The ISO believes that equipment failure belongs in the forced outage rate calculation.

- Duke's termination provision (Section 2.21(v)) would not bind a new owner to file a contract under substantially the same terms, as is required under the PG&E Agreement.

- Duke would be able to move to the "B" contract 90 days from ISO operation, even if Duke gives less than 90 days notice. (Section 3.2(a).) Currently an owner must give 90 days notice. (Section 2.3 and 3.2.) Duke's proposal allows it to weigh market risks right up to a conversion to a "B" contract.

- Duke provides a right to roll *back* to an "A" contract at the start of a new year. (Section 3.2(b).) The PG&E contract would limit conversion to once a year and requires rollover on whatever version the unit is on at the end of the previous year. (Section 2.1.) Duke also provides for more frequent changing from B to A and *vice versa* and with 30 days notice, not 90 days. (Section 3.6(a).) Duke's approach promotes seasonal gaming, *i.e.,* an ability to participate and recover its costs during the peak summer months and then recover additional fixed costs in the winter under a "B" contract.

- Duke has added an *obligation* on the ISO's part to issue dispatch notices, rather than the permissive language in PG&E's version. (Section 3.1(f) of Agreements "A", "B", and "C".) This creates a materially different liability for the ISO. The ISO must have the absolute authority to call on the unit when necessary if it is available. No provisions of the contract can impede this ability.

- Duke has materially altered the schedules governing what happens if the ISO needs to issue a dispatch notice above the various limits. (Section 4.3.) Given the uncertain nature of the RMR need in the initial years, any further limitation could have significant cost and reliability implications. Duke also adds a new limit for "maximum hourly generation." Monthly limits do not make reliability or financial sense from the ISO perspective. They only represent an artificial interim limit that has a significant potential to raise costs.

- Duke has added a 2% margin for error for availability testing. (Section 4.5(a)(iii).) The PG&E Agreement does not contain a margin of error.

- Duke has significantly limited the ability of the ISO to deny capital expenditures. (Section 9.4.) Since the ISO is obligated to pay an exit fee for unrecovered capital expenditures, Duke's proposal could substantially bias any evaluation of alternatives to Duke's RMR units.

- Duke has lowered its obligation to "reasonable efforts" from "best efforts" in a number of places. (Section 10.3.) This change allows Duke to consider economics in deciding whether to comply with the ISO's directive. Again, nothing in the contract can impede the ability of the ISO to dispatch units which are critical for reliability. RMR units have by definition locational market power and must be treated as such.

- Duke seeks coverage under the ISO's errors and omissions insurance policy. (Section 12.2(b).)

- Duke has limited the period in which the ISO can audit Duke's books. (Section 12.4.)

- Duke has significantly altered the indemnification provisions. (Section 12.8.)

Other provisions of Duke's RMR Agreement that are substantially different from PG&E's RMR Agreement are set forth in Attachment 1 to the ISO's motion to intervene and protest Duke's filing in Docket No. Docket No. ER98-2669-000, filed May 14, 1998 (attached hereto). In short, the Duke Agreement falls far short of providing an adequate replacement for the PG&E RMR Agreement, and PG&E should not be permitted to terminate service based on such a filing.

D. Reliability is at Risk if PG&E is Allowed to Terminate Service Absent the Filing of an Adequate Replacement RMR Agreement

Aside from the fact that PG&E's RMR Agreement does not allow termination under the current circumstances, PG&E has not shown it would be just and reasonable to terminate its RMR Agreement. Before service under a filed rate can be terminated, the termination must be shown to be in the public interest. *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414 (1952). As PG&E correctly points out at page 6 of its Notice of Termination, in determining whether a Notice of Termination should be approved, the Commission examines "whether the situation that will exist after the Agreement terminates is just and reasonable… that question must be answered by examining what the proposed termination does, what harm if any, it causes." Citing *Pacific Power & Light Co.,* 23 FERC ¶ 61,402, at 61,890 (1983). In such an inquiry the burden is on the party filing the Notice of Termination to show the filing is just and reasonable. *See Power Auth. of New York v. Niagara Mohawk Power Corp.,* 79 FERC ¶ 61,159, at 61,747 (1997), *Pacific Gas & Elec. Co.,* 78 FERC ¶ 61,173, at 61,716 (1997).

However, PG&E fails to go on and apply that test in any meaningful way. If PG&E is permitted to terminate RMR service, the ISO will be forced to take the associated RMR services under terms and conditions that materially differ from those for every other RMR unit. The ISO is not in fact being offered the same service except in the grossest sense of the word, and is clearly being harmed by the increase in the burden and cost of administering the contracts. Moreover, as noted below, there are significant increases in cost and adverse effects on reliability if PG&E does not meet its contractual obligation to terminate only upon a substantially similar contract being filed.

The ISO will not execute or support a rate schedule filed with the Commission by a new owner that does not include substantially the same terms and conditions as the contract being replaced. Having substantially the same terms for all RMR Agreements is critically important for the ISO to operate Reliability Must Run services efficiently and effectively. That condition of uniformity was included specifically to avoid forcing the ISO to litigate terms and conditions each time a unit owner chooses to file a completely new agreement—in particular when an agreement is so different it cannot be redlined against the predecessor and requires 12 pages just to summarize the differences (*see* Attachment 1 to the ISO's May 14, 1998 Motion to Intervene and Protest filed in Docket No. ER98-2669-000, attached hereto).

The ISO's RMR structure was carefully crafted to recognize the need for uniformity of these agreements. The conditions under which an RMR Agreement may be assigned (only with ISO consent) or a unit conveyed and a new agreement filed (only on similar terms with the new owner and with the additional protection that any initial rate must be found just and reasonable before it is allowed to go into effect) are policy choices made by the California market participants, including PG&E. Moreover, these are reasonable conditions that are fundamental to the ISO's ability to operate reliably.

Allowing each RMR contract to specify different communications protocols, timing and structure of Dispatch Notices, the conditions under which the ISO may call upon the units or the conditions under which the units would be required to furnish service, would wreak havoc with ISO operations. ISO dispatchers would have to treat each RMR facility differently and either develop photographic memories of each separate RMR contract or be forced to consult each unit's contract before every RMR transaction—an impossible task when trying to dispatch units in real time.

In order to carry out its reliability responsibilities, the ISO must be able to call upon an RMR unit when it needs it, and, because such needs often arise from unforeseen events (such as the loss of transmission lines), call upon the unit with little or no advance notice. In addition, the ISO must be able to call upon the unit using uniform, simple terms. Any unit-prescribed differences in ISO-unit communications introduce complexity. Complexity introduces delay. Delay results in inaction and inaction will adversely impact reliability.

Moreover, the unit must provide service when called upon. The RMR units are one of the ISO's primary tools in maintaining system reliability.[4] For some system problems, they are the ISO's only tool. If the unit's owner has the right to provide service only under that unit's individual terms, the ISO may not have guaranteed access to the services of that unit.

---

[4] For example, PG&E's operating instructions to the ISO on reliability requirements in the San Francisco Bay area (the O-49 procedure) provides that one of the Moss Landing units must be on line for voltage control in the Santa Cruz and San Jose areas.

The process the ISO goes through when dispatching RMR units simply will not lend itself to a myriad of terms and protocols. In advance of the operating day the ISO must:

- Project loads and other operating conditions;
- Determine what the system's reliability needs are based on those projections;
- Determine what combinations of units are needed to meet those reliability needs;
- Evaluate what energy and Ancillary Service needs have been met through the market after the market closes;
- Determine the most cost-effective way to use RMR units to meet the reliability needs that the market has not provided;
- Ensure that the RMR units are being utilized within their contract constraints (*e.g.* service limits, operational restrictions on start-ups and ramps);
- Prepare the loading instructions for the RMR units, and distribute them to the units' Scheduling Coordinators.

During the operating day, the ISO must:

- Monitor the system to ensure the day-ahead RMR schedules are being met;
- Follow the system conditions to ensure real-time reliability needs are being met;
- Where they are not, either due to inaccurate forecasts or unplanned outages, determine the new reliability needs;
- Gauge how real-time market bids may be used to address real-time changes in reliability needs;
- Determine the most cost-effective way to use RMR units to meet the reliability needs that the market has not provided;
- Ensure that the RMR units are being utilized within their contract constraints (*e.g.*, service limits, operational restrictions on start-ups and ramps)
- Prepare the loading instructions for the RMR units and distribute them to the units' Scheduling Coordinators.

All the actions listed above for both time frames—before and during the operating day—must be logged to allow for proper payment, audit and dispute resolution.

As the two lists above indicate, dispatching RMR units within the overlapping frameworks of market auctions and RMR contracts is a complex process. Without uniform RMR contracts, the system operator would have to consult each individual contract before calling on that unit to provide service to ensure the ISO was complying with the terms and conditions of that contract. This would inevitably create delays, and since RMR units are, by definition, those units that must run to ensure system reliability, the potential price to be paid for any delays within these processes is the loss of system reliability. In the initial weeks of operation, many real-time RMR decisions have been made in minutes on the operating floor to maintain system reliability. If the decisions are complicated by significant contractual differences or potential situations where the owner may decline to serve, reliability will be impaired.

The ISO is charged with maintaining system reliability, but is charged with doing so at the least possible cost, so as to benefit its broadest constituency—the ratepayers of the State of California. Except for in the most dire of emergencies (emergencies which the ISO will diligently strive to avoid through the proper, pro-active dispatch of RMR units), the ISO must consider the costs of RMR units for the reliable dispatch of RMR units. To suggest something else can be done is to turn the restructuring of California's electric industry into an "at-all-costs" exercise, which is the exact opposite of what that restructuring was meant to accomplish—a reduction in the overall of cost of reliable electric production and distribution. Thus it is essential that PG&E be required to continue to provide RMR service until such time as an adequate replacement agreement is on file with the Commission.

E. The ISO Faces Substantial Additional Costs And Risks Associated With Its Financing If The Commission Allows PG&E to Terminate Service

The ISO's ability to obtain financing has been dependent on its ability to eliminate the payment risk that would occur if a Participating Transmission Owner (PTO) did not make payment to the ISO and the RMR unit owners demanded payment from the

ISO. When the ISO first sought financing, no bank was willing to lend to the ISO unless the ISO's obligation to RMR unit owners was "non-recourse"—payable solely out of amounts collected from the relevant transmission provider. So long as the transmission provider also is the RMR unit owner, the ISO has the equivalent of a non-recourse obligation since there is an express right of set-off in that case.

The RMR unit owners who purchased SCE Must-Run plants, SCE, and SDG&E have agreed to equivalent non-recourse liability in a "Principles of Agreement." Tariff and contract language is being drafted to accomplish that agreement in principle. [5] PG&E's January 29, 1998 filing included similar language, but PG&E withdrew that provision in an *"errata"* notice filed March 6, 1998.

Before any PG&E units were sold and on the strength of the SCE and SDG&E agreements in principle and an expectation that an agreement with PG&E could be reached, the ISO, in consultation with its lenders, arranged for the sale of $301,400,000 in tax-exempt variable rate demand bonds issued by the California Economic Development Financing Authority and backed by a letter of credit issued by Bank of America National Trust and Savings Association (BofA). The first tranche of $101,600,000 was sold May 5, 1998. The second, of $199,800,000, was sold May 15, 1998. Because BofA provides the credit support, the ISO's representations, warranties, and continuing covenants are principally to BofA through the Reimbursement Agreement. The Reimbursement Agreement provides the following in Article VII, Negative Covenants of the ISO, Section 7.9, Must Run Agreement Units:

> SECTION 7.9 <u>Must-Run Agreement Units.</u> The ISO shall not designate a unit as a Reliability Must-Run Unit as provided in Section 5.2.3 of the Tariff unless (i) the Owner of such unit has agreed that it has no recourse to the ISO in respect of any Reliability Must-Run Charge in the event the ISO has not received the Reliability Must-Run Charge from the applicable PTO (a "Pay When Paid RMR") and (ii) the applicable PTO has agreed

---

[5] Changes will be made to ISO Settlement and Billing Protocol Annex 1, Settlement and Billing of Reliability, Must-Run Charges and Payments.

> that it will pay to the ISO all Reliability Must-Run Charges invoiced to the PTO in respect of such Reliability Must-Run Unit without setoff; provided, however, that such agreement may allow such PTO to make such payment under protest and to obtain a refund, with interest, of any invoiced amount determined not to have been due and payable, which refund (with interest) shall be netted against future payments from such Owner.

Duke's contract would result in a breach of the above covenant and trigger an event of default. The Reimbursement Agreement provides that a violation of Section 7.9 is an event of default under Article VII, Section 8.1.c.

BofA has advised the ISO that if PG&E refuses to agree to principles of agreement substantially similar to those agreed to by SDG&E, SCE and the SCE unit purchasers, and FERC accepts Duke's filing and permits it to become effective, BofA will impose substantial restrictions on the use of the proceeds of the second issuance.[6] In addition it is likely that BofA may also:

- create a term loan for the $76,872,000 of disbursements for working capital and completion of infrastructure at a substantially increased interest rate (prime plus 3%) that is payable over one year in 1999, rather than ten years;

- require that the remaining funds not disbursed would be used to provide collateral for the Letter of Credit and to redeem the outstanding bonds

These lending restrictions exist because the potential liability of the ISO for RMR payments is very large relative to its overall operation budget. For example, the total for all must-run services during a peak season month alone could total $152.7 million, an amount equal to the ISO's annual operating budget. The RMR Agreements are estimated at costing between $1 to $2 billion for 1998. The ISO estimates the

6 As a condition to the second issuance, the BofA has required the ISO to execute an amendment to the Reimbursement Agreement providing severe limitations on the use of bond proceeds until "such time . . . as . . .the Banks have received from the ISO and Pacific Gas and Electric Company ("PG&E") a fully executed agreement in form and substance satisfactory to the Issuing Agent, the Agent and the Banks regarding the sale by PG&E of its Reliability Must-Run Units." Reimbursement Agreement, Amendment 1, Section 6.13.

potential financial impact of these restrictions to be between $2 and almost $4 million in increased interest costs. In addition, the ISO will be required to make payments that could increase the Grid Management Charge by approximately $0.5248/MWh for 1999 to repay the one-year term loan if PG&E and Duke impose their terms on the ISO.

This potential cost increase can be wholly avoided if PG&E retains ownership of the units. All but approximately $800,000 in increased borrowing costs can be avoided if PG&E agrees to the "Principles of Agreement" already agreed to by SDG&E, SCE and the SCE owners. The ISO respectfully submits that any request for termination putting the ISO in such a materially adverse financial situation is not in the public interest, and must be denied or conditioned upon mitigating the impact on the ISO.

In sum, until PG&E can demonstrate that the ISO will receive the necessary RMR services under a subsequent agreement without irreparable operational or financial harm, the Commission must find that PG&E's proposed termination of service is not in the public interest and must be summarily denied.

VI. CONCLUSION

Wherefore, based on the foregoing, the ISO respectfully requests the Commission to permit the ISO to intervene and be treated as a party to this proceeding with all rights appropriate to that status, and requests the Commission to duly consider the protest, and grant the ISO's motions for consolidation and summary disposition filed herein.

Respectfully submitted,

N. Beth Emery
Vice President and General Counsel
Roger E. Smith, Regulatory Counsel
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-2334
Fax: (916) 351-2350

Fiona Woolf
Bridget E. R. Shahan
Cameron McKenna LLP
2000 Pennsylvania Ave., N.W.
Suite 8550
Washington, D.C. 20006
Tel: (202) 466-0060
Fax: (202) 466-0070

Stephen Angle
Robert C. Fallon
Linda L. Walsh
Howrey & Simon
1299 Pennsylvania Ave., N.W.
Washington, D.C. 20004-2402
Tel: (202) 383-7261
Fax: (202) 383-6610

Date: May 20, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the forgoing document upon each person designated on the official service list compiled by the Secretary in this Docket No. ER98-2785-000, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (1997).

Dated at Washington, D.C. on this 20th day of May, 1998.

____

Julie B. Greenisen