

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Pacific Gas & Electric Company, et al.) Docket Nos. ER97-2355-002,
) ER97-2358-002, and
) ER97-2364-002, et al.

To: The Honorable Stephen L. Grossman
Presiding Administrative Law Judge

**POST-HEARING REPLY BRIEF
OF
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

N. Beth Emery	Edward Berlin
Vice President and General Counsel	Kenneth G. Jaffe
Roger E. Smith, Regulatory Counsel	Michael E. Ward
California Independent System Operator Corporation _____	Swidler Berlin Shereff Friedman, LLP 3000 K St., NW
151 Blue Ravine Road	Suite #300
Folsom, CA 95630	Washington, DC 20007
Tel: 916-351-2334	Tel: 202-424-7500

Counsel for California Independent System Operator Corporation

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INTRODUCTION AND SUMMARY

As described in the Initial Brief of the California Independent System Operator (“ISO”), Issue No. 16 concerns the services offered by Pacific Gas & Electric Co., Southern California Edison Company (“Edison”) and San Diego Gas & Electric, (together, the “Companies”) over their subtransmission and distribution systems (together, the “distribution” systems). The Companies have filed Transmission Owner (“TO”) Tariffs to establish charges for transmission service under the ISO Tariff (Item by Reference G, hereinafter “ISO Tariff”) on the ISO Controlled Grid¹ and Wholesale Distribution Tariffs for service on the TO’s distributions system to and from the ISO Controlled Grid.

In their Initial Briefs, Enron Power Marketing, Inc. (“Enron”) and New Energy Ventures, Inc. (“New Energy Ventures”) have argued that the Commission should require the TO’s also to offer service directly from a Generating Unit on a distribution

¹ Unless otherwise specified, capitalized terms included herein have the meaning given them in the ISO Tariff.

system to a Load on the distribution system if the customer can demonstrate that the power does not flow over the ISO Controlled Grid (“distribution-only’ service”). In support of these arguments, Enron and New Energy Ventures cite primarily the Edison distribution facilities, which comprise a number of radial arms, connected to each other only through the ISO Controlled Grid under normal operating procedures.

Enron and New Energy Ventures base their argument primarily on the thesis that “distribution-only” service does not implicate the ISO Controlled Grid. This thesis is fundamentally flawed. “Distribution-only” service is a misnomer. Generation and Load on distribution lines that are interconnected with the ISO-Controlled Grid cannot be divorced from the ISO-Controlled Grid. As control area operator, the ISO must not only provide Ancillary Services and Imbalance Energy for transactions that occur on the Companies’ connected distribution systems, but it must ensure the reliability of those services, schedule them, and dispatch them in response to such events as a mismatch of Generation and Load on the distribution systems. These activities require extensive use of the ISO Controlled Grid, the cost of which customers that enjoy these reliability benefits must share.

Enron and New Energy Ventures would attempt to avoid their cost responsibility by requiring each of the Companies in essence to operate its distribution system as a separate control area. This balkanization of control area responsibilities is not only contrary to the Commission’s ISO principles, but would sacrifice the economic and reliability efficiencies the ISO was established to achieve in order to enhance the economics of a relatively small percentage of transactions. The Presiding Judge should reject these efforts.

ARGUMENT

Issue No. 16: Should Wholesale Only Service on the Companies’ Distribution Systems Be Required? If So, Should the Companies Be Required to File Appropriate Tariff Provisions?

I. “DISTRIBUTION ONLY” TRANSACTIONS IMPLICATE THE ISO GRID AND THEREFORE REQUIRE SERVICE UNDER THE ISO TARIFF

Enron’s initial arguments are that requiring transactions involving Generation and Load on the same distribution system to take service under the ISO Tariff subject the transactions to charges unrelated to services received and impose unnecessary ISO requirements on Generators. Similarly, New Energy Ventures argues that “distribution-only” transactions do not make use of the ISO Grid. These arguments must fail because they are premised on a simplistic, and fallacious, understanding of the services provided by the ISO and the nature of the ISO’s need for information.

A. The ISO Services Provided in Connection with “Distribution Only Service” Justify Application of the Charges Under the ISO Tariff

Accepting for the purposes of this argument that the ISO provides reliability benefits and Ancillary Services to Generators and marketers using “distribution-only” service, Enron argues that the ISO provides such Generators and marketers no services related to the physical operation of the ISO Controlled Grid, and that requiring those entities to pay all ISO-related charges violates cost causation principles. (Initial Brief of Enron (hereinafter “Enron Br.”), at 51-52.) New Energy Ventures similarly contends that, under comparability principals, taking Ancillary Services from the ISO should not require the purchase of transmission service. (Initial Brief of New Energy Ventures, (hereinafter “NEV Br.”) at 10-11.) Enron and New Energy Ventures are wrong about both the nature of the services provided and the applicability of cost causation principles.¹

¹ In support of its argument, New Energy Ventures asserts that the Commission has expressly held that ancillary services purchased from a control area operator do not require the purchase of transmission service from that control area operator. (NEV Br. at 9.) Under the pro forma open access tariff, however, transmission customers *must* also take and pay for scheduling, system control, and dispatch services from the control area operator. *See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service By Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, III FERC Stats. & Regs.

First, the Ancillary Services and reliability benefits that Enron describes are directly related to the physical operation of the ISO Controlled Grid. The ISO not only sells Generation-related Ancillary Services, but also procures them, operates markets to facilitate the availability of both procured and self-provided Ancillary Service, schedules and dispatches those services, and ensures their reliability. *See generally*, ISO Tariff § 2.5.² This requires, among other services, contracting for some services and procuring others through a daily and hourly auction, ISO Tariff §§ 2.5.5, 2.5.8, informing successful bidders and scheduling their services, ISO Tariff § 2.5.21, determining and maintaining a merit order list for dispatch, ISO Tariff § 2.5.22.2, monitoring the need for Imbalance Energy and dispatching it accordingly, ISO Tariff § 2.5.22.6, and testing the resources providing the Ancillary Services, ISO Tariff § 2.5.25. The costs of these services are not included in the costs of Ancillary Services, which are billed and paid according to the auction price. In addition, the ISO's management of Congestion on the ISO Controlled Grid protects distribution systems from inadvertent flows from the transmissions system into the distribution system that would interfere with the use of that system for the "distribution-only" service. §§ 2.5.22.7, 2.5.22.8.

¶ 31,036 at 31,715, 31,934 (1996) (hereinafter "Order No. 888"). Under the ISO Tariff, customers do not pay for Scheduling, System Control, and Dispatch Services as a separate service. Neither are the costs of these services included in the charges for other Ancillary Services, which are billed at cost. Rather, these services are included in a charge for those taking service under the ISO Tariff. This arrangement was specifically recognized and approved by the Commission. *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,490 n 282 (1997). Under "distribution-only" service customers would avoid this charge, as well as a share of the cost of the facilities through which the service is performed. In addition, it should be noted that the Commission only requires transmission providers to provide Ancillary Services to persons taking basic transmission service. Order No. 888 at 31,715.

² Enron states elsewhere in its Initial Brief that the ISO Tariff is not relevant to whether the Companies' tariffs are just and reasonable. (Enron Br. at 14.) This assertion ignores the obvious fact that the vast majority of the ISO Tariff provisions, which establish the structure under which the Companies' TO Tariffs and WDTs must operate, has been accepted by the Commission under Section 205 of the Federal Power Act. The standard in Section 205, of course, is that a tariff be just and reasonable.

Further, Ancillary Services are procured from resources all over, and outside of, the ISO Controlled Grid. It is only by means of the ISO Controlled Grid that these services can be used to satisfy the ISO reliability requirements for the benefit of all customers in the control area.

Second, the Commission has determined that a customer receiving such services from a transmission provider should bear its share of the entire rolled-in cost of the transmission system. In *Niagara Mohawk Power Corp.*, 42 FERC ¶ 61,143 (1988), a customer that was served by only a portion of the transmission provider's system argued for direct assignment of costs or, alternatively, a rate based on only part of the transmission provider's system. In rejecting this argument, the Commission noted that the transmission system was a fully integrated system that provided a high degree of reliability that does not exist when only specific lines are used and that the transmission provider would be required to provide service if the lines normally used became unavailable. The Commission stated, "Because the . . . customers enjoy the benefits of reliable service by their association with the . . . integrated system, they should share in the cost of the entire transmission system." *Id.* at 61,531.

A. **The Requirements Imposed on Generators by the ISO Tariff Are Reasonable Concomitants to the Benefits Received by Generators**

Enron further asserts that requiring "distribution-only" customers to take service under the ISO Tariff is unreasonable because it imposes unnecessary requirements on the Generators. Enron acknowledges that the requirements are designed "to allow the ISO to use generating resources scheduled with it to maintain grid reliability." (Enron Br. at 54.) Enron cites two reasons: that the output of the Generators is often extremely small and that the output is consumed entirely on the local distribution grid. *Id.* New Energy Ventures makes similar arguments. (NEV Br. at 6-7, 9.)

The first reason of these reasons, however, is not an argument for “distribution-only” service, but rather an argument for exempting certain Generators from the requirements of the ISO Tariff because they are incapable of providing reliability benefits to the ISO. Yet, as Enron acknowledges, the ISO Tariff already exempts Generators under 10 MW whose output remains within a distribution system from the requirements it describes. (Enron Br. at 55-56.) If Enron and New Energy Ventures believe that the 10 MW limit is too low, they should address that concern in the context of the ISO Tariff. Even if some Generator above 10 MW were deemed too small to provide reliability benefits to the ISO, this fact would not justify exempting all Generators involved in “distribution-only” transactions from a share of responsibility for the reliability of the facilities in the ISO Control Area.

The second reason fares no better. The passage in Mr. Perez’s affidavit to which Enron referred Mr. Cullier to confirm that power does not flow from that distribution system to the transmission network, describes that circumstance as existing “under normal operating conditions.” Tr. at 160; Exh. EPM-5 at 8. An imbalance between Generation and Load is not a “normal operating condition” in this context. If the ISO calls upon Generators on the distribution system under Section 5 of the ISO Tariff to increase or decrease Generation for reliability reasons, those normal operating conditions may not exist. If the ISO directs such a Generator to increase or decrease Generation in response to a change in Load on the same distribution system, the ISO is preventing unscheduled flows into or out of the ISO Controlled Grid that could affect reliability. Similarly, If the ISO directs a Generator to increase or decrease Generation in response to a change in Load outside of the same distribution system, it will be scheduling additional flows into *or out of* the distribution system.³ In either case, the

³ The passage of EPM-5 that New Energy Venture’s cites explicitly notes that power flows out of the distribution system in cases of maintenance or emergency conditions. (NEV Br. at 7.) More precisely, it flows out of the distribution system when Generation on the system exceeds Load. Whether it flows into the transmission system or another

ISO would receive reliability benefits from these units. The information provided by Section 5 allows the ISO to call upon units located on the distribution system for the benefit of all Market Participants in the ISO Control Area, including “distribution-only” customers.

I. THE ISO PROVIDES RELIABILITY BENEFITS IN CONNECTION WITH ALL TRANSACTIONS ON THE DISTRIBUTION SYSTEM

Enron further contends that “distribution-only” service should not be scheduled with the ISO because Generators on the system are not dependent on the ISO to maintain reliability related to their output. Enron makes its argument separately for large units and small units (i.e., those with capacity under 10 MW). Both of these arguments are fundamentally flawed by Enron’s failure to recognize the scope of the ISO’s responsibilities as the Control Area Operator. As the Commission has recognized, the ISO’s responsibility as Control Area Operator require it to ensure that Load and Generation on the ISO Controlled Grid remains in balance. *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,456, 61,490. The vast majority of the Load, however, is located off the ISO Controlled Grid on the distribution systems. In addition, Generation located on the distribution systems, unless perfectly balanced with its Load, will affect the balance on the ISO Controlled Grid. As described by the Commission’s pro forma Open Access Tariff, the Control Area for which the ISO has responsibility comprises --
An electric power system or combination of electric power system(s) to which a common automatic Generation control scheme is applied in order to:

distribution system would depend on the operation of connections between the distribution systems. (Exh. EPM-5 at 12-13.) It should be noted, however, that Mr. Cullier was not cross-examined on this passage and according to the ruling of the Presiding Judge it is not part of the record and should not be cited except as discussed in testimony (Tr. at 161-62). Thus, Mr. Cullier did not have an opportunity to discuss how the ISO’s assumption of Edison’s control area responsibilities (including the general requirement that the ISO address reliability at the lowest cost, *see, e.g.*, ISO Tariff at §§ 2.5.22.6.) and the addition of new Generation such as Enron describes, (Enron Br. at 49) has and will affect these power flows.

(1) Match, at all time, the power output of Generators within the electric power system(s) and capacity and energy purchased from entities outside the electric power system(s), with the Load within the electric power system(s);

...

(3) maintain the frequency of the electric power system(s) within reasonable limits in accordance with Good Utility Practice; and

(4) provide sufficient generating capacity to maintain operating reserves in accordance with Good Utility Practice.

Order No. 888 at 31,930. The reliability of the distribution system and the reliability of the ISO Controlled Grid are inexorably intertwined.

A. **“Distribution-Only” Transactions Necessarily Rely Upon the ISO to Address Reliability Concerns.**

Enron suggests that certain transactions do not require Ancillary Services from the ISO, and therefore need not take service under the ISO Tariff. To support this argument, Enron cites the Sacramento Municipal Utility District (“SMUD”) and utilities in Montana as examples where Generators can affect the operation of the ISO Controlled Grid but are not required to take service under the ISO Tariff.

There is no testimony in this proceeding regarding the circumstances under which SMUD engages in transactions on its own system. SMUD is a party to a number of existing agreements, *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,320 at 62,474-75 (1997). Under the ISO Tariff, these agreements must be honored, including their provisions for Ancillary Service. ISO Tariff §§ 2.4.3 et seq. To the extent SMUD requests service beyond that provided under its Existing Contracts, it would take such service under the ISO Tariff. Unlike Enron and New Energy Ventures, SMUD owns its own subtransmission systems. The Commission does not have jurisdiction over SMUD’s system because SMUD is a municipality. In short, one cannot draw any

analogies from SMUD's transactions to the "distribution-only" transactions sought by Enron and New Energy Ventures.

Enron acknowledges that Montana is not affected by ISO operations if the ISO operates properly within its Control Area, but suggests that an analogous situation exists within Edison's distribution system. The critical difference, however, was admitted by Enron's witness: a distribution customer within the Edison distribution system *is part of the ISO Control Area*. Tr. at 233. The ISO is responsible for the interaction of that customer's transactions with those of other customers within the ISO Control Area. It is *not* responsible for maintaining reliability in Montana.

Enron in essence suggests that each distribution system be set up as a Control Area, with the Companies ensuring its reliability and the availability of Ancillary Services. Enron's scheme would be contrary to ISO Principle No. 4, Order No. 888 at 31,731, contrary to the Commission's requirements that the Control Area Operator exclusively provide certain Ancillary Services and dispatch all Ancillary Services, Order No. 888 at 31,715-17, and contrary to the Commission's orders concerning the ISO, *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,456, 61,495-61,500. It must be rejected.

A. **Generators Less than 10 MW Are Dependent on the ISO for Reliability Purposes and Must Take Service Under the ISO Tariff**

Enron also argues that, because the ISO has exempted units under 10 MW from various requirements under Section 5 of the ISO Tariff, none of the controls that the ISO considers necessary to maintain reliability over the ISO Controlled Grid are relevant to small Generators. (Enron Br. at 55.) It goes on to argue, because the ISO does not rely upon these Generators for reliability purposes, there is no need to schedule transactions with such Generator with the ISO and such Generators need not take service under the ISO Tariff. (*Id.* at 56.) Enron's argument, however, conflates the

ISO's need for information about these Generating Units with the responsibility of customers of these units to pay for benefits received.

Enron acknowledges that the requirements from which the smaller units are exempted "are designed to allow the ISO to use generating resources scheduled with it to maintain grid reliability." (Enron Br. at 54.) The exemption represents a conclusion that the benefits that the ISO would gain from the ability to call upon these units does not justify the costs to these units of compliance. Nonetheless, these units are part of the ISO's responsibilities as Control Area Operator. Enron's witness admitted that, if one of these units fails, the ISO will supply that unit's Load. (Tr. at 229-30.) If there is an unplanned reduction in a unit's Load, the ISO must absorb the excess Generation. (*Id.*) The ISO must schedule and dispatch Ancillary Services for these units. (Tr. at 233.) *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,456; Order No. 888 at 31,715, 31,934. The issue is not whether transactions with these units should be scheduled. It is whether customers should pay for services received and the facilities over which those services are provided. As the ISO explained in its Initial Brief, principles of cost causation require that they do so.

I. THE COMMISSION'S POLICIES ON UNBUNDLING DO NOT ARGUE FOR THE OFFER OF "DISTRIBUTION-ONLY" SERVICE

New Energy Ventures also argues that the limitation of wholesale distribution service to customers taking service under the ISO Tariff is incompatible with the Commission's unbundling requirements in Order No. 888. NEV Br. at 5, 7-9. Yet, other than noting that the Commission unbundled Generation, transmission, and ancillary services, New Energy Ventures offers no basis for its conclusion.

The Commission did, however, address wholesale distribution in one regard. It stated that when a transmission customer requires service over a transmission provider's distribution system, the transmission provider may include a distribution charge in its service agreement. *Promoting Wholesale Competition Through Open*

Access Non-Discriminatory Transmission Service By Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order on Rehearing, Order No. 888-A, III FERC Stats. & Regs. ¶ 31,048 at 30,308-09 (1997). The Commission in essence recognized wholesale distribution service as an adjunct of transmission service, not a separate service. Thus, absent the ISO, Edison would provide wholesale distribution service under its Open Access Transmission Tariff. The establishment of the ISO should not change that result.

The Commission also concluded that unbundling retail transmission and distribution from wholesale transmission was unnecessary. Order No. 888 at 31,698-99. It concluded that certain Ancillary Services must be purchased from transmission providers if, as control area operators, they are capable of providing those services. *Id.* at 31,715. As noted above, the Commission also approved the ISO's linkage of scheduling, system control, and dispatch service to taking service under the ISO Tariff. *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,490 n. 282.

In short, the Commission has fully recognized that “unbundling” is not a magic word, whose utterance alone is sufficient to resolve any controversy. The value of unbundling must be reviewed in the context of its impact on the overall system.

In Order No. 888, the Commission set forth its goal:
[T]o ensure that customers have the benefits of competitive priced Generation . . . without abandoning [the Commission's] traditional obligation to ensure that utilities have a fair opportunity to recover prudently incurred costs and that they maintain power supply reliability.

Order No. 888 at 31,652. The California restructuring paradigm, as represented in the ISO Tariff, the TO Tariffs, the WDTs, and the associated agreements, represents one just and reasonable means to achieving that goal. It may not be the only such means; indeed, it may be revised extensively in the reassessment of the ISO Access Charge directed by the California legislature in A.B. 1890, as described in the ISO's Initial Brief. Neither Enron nor New Energy Ventures, however, has shown that the existing

structure is unjust or unreasonable. The Companies should not be compelled to offer a service that would undermine the ISO's ability to ensure a reliable power supply under that structure.

CONCLUSION

As the ISO explained in its Initial Brief, because of the responsibilities of the ISO under its Tariff, as approved by the Commission, there is no distribution service within the ISO Control Area that does not implicate the ISO Controlled Grid. As discussed above, the “distribution-only” service sought by Enron and New Energy Ventures would allow certain customers to avoid cost responsibility for facilities and services that ensure the reliability of transactions on the distribution system. Accordingly, the Presiding Judge should conclude that the WDTs, which do not offer “distribution-only” service, are just and reasonable in this regard.

Respectfully submitted,

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

Edward Berlin
Kenneth G. Jaffe
Michael E. Ward
Swidler Berlin Shereff Friedman
3000 K St., NW #300
Washington, DC 20007
Tel: 202-424-7500
Fax: 202-424-7643