March 23, 2004

Mr. Tom Carter
Power Operations Manager
Western Area Power Administration
Sierra Nevada Customer Service Region
114 Parkshore Drive
Folsom, CA 95630-4710

Dear Mr. Carter:

I am writing to express the comments of the California Independent System Operator ("ISO") regarding the Western Area Power Administration – Sierra Nevada Region's ("Western's") Notice of Final Decision on Operational Alternative for Post-2004 Operations ("Final Decision"). The Final Decision, published in the Federal Register on February 23, 2004, (69 FR 8191) asserted Western's intent to establish a "contract-based sub-control area" ("SCA") operating as an independent entity adjacent to either the ISO or the Sacramento Municipal Utility District (SMUD).

As Control Area Operator for most of the transmission systems in California, the ISO is responsible for providing fair and equal access to the transmission network, ensuring the reliability of the grid, fostering the development of new transmission and generation resources, and providing appropriate oversight of market participants. We have legitimate and serious concerns about any federal action that could impact the ISO's ability to perform these crucial functions effectively.

The ISO has reviewed the Final Decision and has participated in several meetings with Western and other parties to discuss how the SCA plan might be implemented. In our analysis, we believe that the SCA plan incorporates substantially the same reliability and operational risks as the Federal Control Area concept that Western proposed in its 2005 Market Plan on June 24, 2003. We provided comments on that proposal on August 8, 2003.

On January 2, 2004, we provided comments on the December 2, 2003 Notice of Proposed Decision in the Operational Alternatives for Post 2004 Operations (68 FR 67417) detailing additional concerns and emphasizing our belief that Western's customers and the public interest would be best served by an open and transparent process in which the details of each option under consideration would be made available to all interested parties. The February 23, 2004 Final Decision makes clear

that Western does not intend to make such details available until after the decision process is completed.

We remain concerned that the proposed federal action by Western could potentially affect millions of electricity consumers who depend on the integrity of the West-wide transmission system. The serious reliability, operations and cost issues we have raised throughout the public process have not been responsibly addressed thus far.

In addition, we have been largely unable to obtain clarification from Western about the assumptions and data used in their decision process. We do not even know if Western is treating the ISO and SMUD on the same basis. This concern became elevated last week when SMUD was pre-selected to make a presentation on behalf of Western, the Transmission Agency of Northern California and the Pacific Gas and Electric Company regarding coordinated use of the Pacific AC Intertie.

Briefly, our concerns are as follows:

- The SCA decision, if implemented, could seriously compromise the reliability of the entire West-wide grid and is completely inconsistent with the recommendations of the Federal Task Force investigating the causes of the August 14, 2003 eastern blackout.

- The SCA plan greatly increases the complexity of operating the California-Oregon Intertie and could potentially impede the ability of Control Area Operators to respond to grid conditions. Further, the SCA could interfere with the ability of the U.S. Bureau of Reclamation ("USBR") to fulfill its statutory obligation to provide water to customers of the Central Valley Project.

- The SCA could increase costs to Western's customers ($16 – 31 million per year) and shift significant costs to California consumers ($10 – 20 million per year) who would not benefit in any way from the proposed federal action.

Reliability impacts: Maintaining transmission system reliability is a complex endeavor. The entire West-wide grid, comprising 14 states, two provinces of Canada and a portion of Mexico, essentially operates as a synchronously integrated machine, with power flows that must be maintained in balance in real time to match supply and demand for electricity. Ensuring system reliability is made more difficult by actions that exacerbate system complexity, such as the SCA plan.

Significantly, Western did not evaluate reliability implications of the SCA plan during the course of their decision process. Western acknowledges in the Final Decision that the plan must not decrease reliability under the Western Electricity Coordinating Council (WECC)/North American Electric Reliability Council (NERC) operating guidelines, but they have relegated reliability as an issue to be addressed during the implementation phase of the federal process. The assertion that reliability is an issue that can be deferred to implementation gives us great concern. Reliability of the West-wide grid

should be the single largest concern of all responsible transmission providers in the West.

Western's approach to this crucial issue fails to acknowledge that the nature of the SCA plan itself is the source of reliability concerns. Indeed, the U.S. Department of Energy's Interim Report of the U.S./Canada Power System Outage Task Force on Causes of the August 14 Blackout noted "institutional complexities" of reliability arrangements in the Midwest as factors of concern in the ongoing investigation. These complexities included the number of control areas within the Midwest ISO (MISO) as well as MISO's relative lack of reliability-related authority over these control areas. It is simply unconscionable that a federal entity under the jurisdiction of the Department of Energy would contemplate an action that would make grid reliability in the West more difficult to ensure.

Complexity of Operations: The proposed action would bifurcate operation of the California-Oregon Intertie (COI), the major electric transmission artery linking California and the Pacific Northwest. During the summer months, a significant amount of power is imported into California via this pathway, while during the winter months, power is dispatched through the COI to meet higher electricity demand in the Northwest. The three COI lines are currently operated as one path under the control of the ISO, working cooperatively with the Bonneville Power Administration (BPA). In the event that corrections or curtailments are necessary, all three lines can be used to make adjustments and with the depth of resources in the ISO Control Area, quick and large changes can be made directly with BPA to accommodate any changing electric needs. The SCA plan would significantly increase the complexity of coordination between operators, impose a second set of scheduling procedures and protocols on market participants, and greatly increase the difficulties of responding to emergency conditions by limiting the response options available.

Western is now advocating the creation of still another layer of operating complexity in the form of an independent Path Operator at COI, separate from either the proposed SMUD or ISO Control Area operator. This additional operating path manager would give instructions to the Control Area (or Areas) on the California side of this critical transmission path, which would then coordinate with BPA to resolve path contingencies or disturbances. Both BPA and the ISO expressed strong operations and scheduling concerns when confronted for the first time with this proposal on March 15, 2004. Western did not respond to questions related to how this proposal would work technically, but deferred those questions to a technical committee to be formed in the future.

In addition to concerns about the increased complexity of grid operations, we are concerned that the SCA arrangement could potentially jeopardize the USBR's ability to deliver water to federal water customers served by local irrigation districts through the Central Valley Project. Resources available to provide generation in Western's proposed SCA are largely hydropower facilities that are committed to USBR for water delivery. In case of a system disturbance such as loss of one of the three lines at COI,

Western would need a great deal of flexibility to respond, potentially impacting water delivery schedules and decreasing the water resources available to California farmers. This type of action is not necessary within the current configuration, since the ISO can call upon a variety of thermal and other generation resources via supplemental energy bids in case of an unexpected loss of a line at COI. USBR is not currently required to manipulate its water resources unless an extreme, grid-threatening emergency condition exists.

Western has proposed to address this problem by arranging for the ISO to continue to operate the COI with its much larger and more diverse resource base. However, nothing that we have observed in Western's budget or economic analysis provides for this complex solution. Further, it is not clear whether the organizations charged with establishing reliability standards (WECC and NERC) would allow such an arrangement.

Increased costs: Increased "seams" issues would likely increase transactions costs for the entire system. In addition, Western could impose an anti-competitive congestion charge on users of the West-wide grid even if total transmission capacity over the COI pathway was adequate. This would result in cost transfers from Western's preference power customers to the balance of California electric consumers through a "pancaked" transmission ("wheeling") charge that amounts to a "toll" that Western has proposed to collect on the COI lines to off-set the increased costs from the expiration of a 1960's era agreement.

The SCA plan, if implemented would be significantly more costly than ISO-proposed options that Western join the ISO as a Metered Subsystem (MSS) or Participating Transmission Owner (PTO). We estimate that this would save Western $15 to $31 million annually. Other benefits of this approach include the ability to allocate costs based on cost causation, ability to treat resources on an aggregated basis, full participation in the ISO ancillary service and energy markets, and exemption from non-contingency blackouts. The MSS option can be readily implemented with no additional hardware, software or manpower costs to Western and without the increased complexities seams issues and costs that Western's SCA plan would impose on California. The MSS option could easily be implemented by year's end, since Western is essentially operating with the ISO in this configuration at present, with the exception that Western would take over scheduling responsibilities from PG&E.

The ISO has been joined in its opposition to the reliability, operations and costs impacts of fragmenting the California electrical grid by a number of important entities, including the California Public Utility Commission, the California Electricity Oversight Board, The Utility Consumers' Action Network, The California Manufacturers & Technology Association, the Market Surveillance Committee, the University of California, Senator Dianne Feinstein, and the three California investor-owned utilities. Surely the opinions of these distinguished organizations and individuals merit scrupulous attention and consideration by the federal entities involved with this action.

The ISO is sincerely committed to develop a responsible, workable structure that will allow Western to continue to operate within the ISO Control Area as a Federal transmission agency. Our goal is to provide safe and reliable transmission service to all California consumers, including Western's customers, with recognition of Federally regulated agencies' needs.

I respectfully reiterate my request that Western remain a part of the California ISO through an open, technically responsible process in which concerned and affected parties can participate in the implementation of the best path forward.

Sincerely,

Randall T. Abernathy
Vice President, Market Services