

**COMMENTS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO THE WESTERN AREA POWER ADMINISTRATION –
SIERRA NEVADA REGION
NOTICE OF PROPOSED DECISION ON THE OPERATIONAL
ALTERNATIVES FOR POST-2004 OPERATIONS**

The following additional comments of the California Independent System Operator Corporation (“ISO”) address issues and concerns of the ISO with the December 2, 2003 Notice of Proposed Decision on the Operational Alternatives for Post-2004 Operations (68 FR 67417) (“Proposed Decision”) of the Western Area Power Administration – Sierra Nevada Region (“Western”). These comments are in addition to the ISO’s August 8, 2003 comments on Western’s proposed Federal Control Area Plan for 2005.

I. IMPLICATIONS FOR GRID RELIABILITY AND OPERATIONS

In its Proposed Decision, Western acknowledges that the selected alternative must not decrease reliability under Western Electricity Coordinating Council (“WECC”)/North American Electric Reliability Council (“NERC”) operating guidelines. However, Western’s Proposed Decision does not directly address coordination of the grid or reliable operation of interconnected Control Areas, but appears to defer these issues until the chosen alternative is implemented. The reliable operation of the grid and coordination of grid operations are substantial issues that may have significant impacts on the cost or flexibility of operation on behalf of Western’s customers. These issues should be foremost in directing the decision and should not be deferred for resolution until after an alternative has been selected. The ISO believes that Western and its customers are best served if all potential issues associated with full compliance with WECC and NERC operating guidelines are resolved before a decision is made between the two remaining options. This will help assure that all costs and risks are identified and can be considered in the context of Western’s adopted decision criteria. Additionally, the Proposed Decision does not address the “seams” issues or issues regarding operation of the California-Oregon Intertie (“COI”), which were serious concerns noted in the ISO’s August 8th comments.

A. Seams Issues

The ISO described in detail in its August 8th comments the numerous “seams” issues that would be created by the transfer of the Western electric system out of the ISO Control Area and incorporates those comments by reference. In addition, the ISO is particularly concerned that the Western transmission capacity, if kept outside of the ISO Controlled Grid and ISO Control Area, will perpetuate a 2-pipe system that may have the potential to facilitate illegal gaming activity and inappropriate market behavior. Another additional “seams” issue is Western’s failure to describe its proposal for

establishing an under-frequency load shedding plan for its external customers. Such a plan is critical for maintaining the reliability of the regional transmission grid. Western has approximately 800 meters in the Pacific Gas and Electric Company (“PG&E”) Service Area, and, therefore, in the ISO Control Area. Absent contracting with PG&E or the ISO, Western will need to ensure that under-frequency load shedding will work in accordance with WECC requirements.¹ The WECC requirements call for a percentage of a Control Area’s load to be capable of being shed through the activation of solid-state under-frequency relays to arrest interconnection frequency decay and uncontrolled separation in the event of a system emergency. The Proposed Decision does not address these concerns.

B. California-Oregon Intertie

The ISO’s August 8th comments also described in detail the numerous issues that would be created by the introduction of a third Control Area into the operation of the COI (Path 66), the major interconnection path between California and the Northwest, and incorporates those comments by reference. However, the ISO wishes to re-emphasize that it is essential that Western’s evaluation of the SMUD and ISO options consider the impact to the COI. On September 3, 2003, Commissioner Peevey of the California Public Utilities Commission issued a letter expressing concern about Western’s proposal with regards to operation of the COI (“CPUC Letter”). The Proposed Decision, however, does not acknowledge this concern and does not address the potentially serious adverse impacts of grid reliability and seams issues. NERC has found that a contributing factor to the August 14, 2003 Northeast Blackouts was a deficiency in establishing and/or maintaining the required communication and coordination among multiple control areas.

Western’s alternative to negotiate with SMUD does not directly address the importance of coordinated operation of this critical transmission path for California’s consumers. The interposition of a third control area at COI was a critical issue which contributed to Western’s decision not to pursue its Federal Control Area option. This same concern must be addressed with regard to the SMUD option. This could be a significant reliability risk for the entire WECC. The most notable element of this risk is the potential to degrade reliability by increasing the coordination requirement with respect to the COI. The status of this path affects - and is affected by - conditions, events and actions in other portions of the Western Interconnection. The ISO is concerned that involving a third Control Area in the operation of the COI may unnecessarily complicate coordinated operations, particularly during system emergencies and efforts to mitigate power flow on the COI, Path 15 and Path 26 with neighboring Control Areas to the North, and would significantly increase the complexities of reliably operating the interconnected grid in California.

Regardless of the chosen option, additional issues that must be addressed are (1) mitigation of unscheduled loop flows at COI; (2) mitigation of COI overloads resulting from operating contingencies; (3) post-separation restoration of the Northwest-

¹ WECC Minimum Operating Reliability Criteria (“MORC”) Section 6-C, Automatic Load Shedding, System Sectionalizing and the Off-Nominal Frequency Operation Plan.

Southwest systems at COI; (4) Path 66 ratings; (5) scheduling practices and procedures; and (6) outage notification and coordination. These issues must be considered and a workable solution defined to determine the option that should be chosen, in advance of selection of the option.

II. WESTERN'S ANALYSIS OF COSTS AND BENEFITS

In the Proposed Decision, Western provides a "revised" cost-benefit study which purports to address some of the ISO's concerns expressed in its August 8th comments regarding the costs and benefits of Western's options. However, with no supporting analysis provided for the revised study, it is impossible to tell how the numbers were derived. While the ISO has concerns with the analysis, it cannot provide specific or comprehensive comments without the necessary back-up data. If Western continues to use cost-effectiveness as a decision-making criterion, both options should be the subject of a fully transparent cost-benefit analysis that is available for all interested parties to evaluate.

The ISO's combination Metered Subsystem ("MSS") and Participating Transmission Owner ("PTO") option results in a \$15-30 million annual savings for Western customers. This cost savings is consistent with the ISO's April 8th formal offer to negotiate an MSS solution tailored to accommodate Western's and United States Bureau of Reclamation's ("USBR") needs. This option can be readily implemented as Western is essentially operating physically in this configuration, at present, albeit with PG&E as its scheduling entity. Western, as a currently certified Scheduling Coordinator with the ISO, would simply schedule on behalf of its own loads and generation resources come January 2005, upon expiration of its contracts with PG&E.

A. Clarification of the PTO Option

The Proposed Decision states that joining the ISO as a Participating Transmission Owner (the "PTO Option") would increase transmission costs because the low cost Western transmission system would be blended with the higher cost ISO grid-wide system. Based on public information available, however, Western's high voltage transmission cost in 2004 is \$ 2.96/MWH² whereas the ISO's transmission Access Charge just filed for January 2004 for the Northern Zone is \$ 2.2191/MWH. Moreover, for 2004, PG&E's high voltage transmission cost is \$2.29/MWH, Southern California Edison's high voltage transmission cost is \$2.14/MWH and San Diego Gas & Electric's high voltage transmission cost is \$2.38/MWH. Thus, Western's transmission cost is greater than that of each of the investor-owned utilities transmission costs, not less. Additionally, if Western's transmission costs were less than the ISO's Access Charge, the Access Charge proposal has a hold harmless clause whereby, if a Participating TO's transmission costs are less than the ISO's Access Charge, the Participating TO is compensated for the difference, and is thus not harmed by any cost increases.

² The value assumed no increased for inflation, operation and maintenance, administrative and general expenses or capital additions to existing High Voltage Transmission Facilities.

Additionally, the PTO Option analysis does not account for any potential congestion revenues, wheeling revenue and Firm Transmission Right (“FTR”) auction revenues, if any, that would be available to Western as a Participating TO. For 2003, this has amounted to, as an example, \$ 278,193 for the City of Vernon based on Vernon’s recent filing with the Federal Energy Regulatory Commission (“FERC”). While this revenue must be credited against transmission costs, these amounts would be available to offset the increased costs for the new personnel Western believes it needs to implement the various options.

While the ISO does not disagree with Western that the ISO’s spot markets were volatile during the peak of the 2000-2001 energy crisis, real time energy market prices have become much more stable and Western’s analysis fails to acknowledge that Western has the capability to avail itself of long-term contracts for balancing Energy and Ancillary Services. In addition, if Western follows its own load, it would be expected to be “long, as often as it is “short” in meeting its own energy needs. Thus Western would “sell” to the real-time market as often as it would “buy” from the ISO’s energy balancing market. Moreover, it seems unlikely that Western would need to procure Ancillary Services given the vast hydroelectric resources of the USBR, on which Western may rely. These services do not need to be procured from the ISO, but they remain as a convenient option for Western to consider in managing its loads and generation resources. Western acknowledges this in its discussion of the option of remaining within the ISO Control Area as a Metered Subsystem (“MSS Option”).

B. Proposal Silent on Cost-Shifts

Western has previously proposed rate “pancaking” on COI to offset the increase in transmission costs that will be incurred by preference power customers on the ISO Controlled Grid. The Proposed Decision is silent on this issue. Both the ISO and the CPUC Letter expressed concern with the proposed \$20 million cost-shift to California’s consumers that would result from such pancaking. If the “SMUD Alternative” continues to propose the cost-shift, the ISO cannot support such a proposal as it is incompatible with non-discriminatory and open access to transmission. In its August 8th comments, the ISO further developed this concern and incorporates those comments by reference.

C. New Investment in Business Infrastructure and Systems

The Proposed Decision includes a description of new investment in business infrastructure and systems independent of Western’s selection of a post-2004 operational alternative. Western proposes a new Scheduling system, Power Billing system, Load Forecasting system, Generation Optimization system, Enterprise Architecture Integration system, Meter Data Repository system and Settlements system. The ISO believes that Western should consider implementation or expenditures for these systems as being premature pending the final decision. With the possible exception of the Power Billing and Enterprise Architecture Integration systems, the requirements for the systems will vary depending on whether Western selects either the ISO or SMUD option. The Proposed Decision’s discussion of the Power Billing system, for example, anticipates “extensive modifications to accommodate hourly market settlements under current utility standards.” However, since September 2000,

the ISO market settlements have been on a 10-minute basis. Thus, the presumption regarding the criteria for the new system would be incompatible with one of the options that Western will be evaluating for the final decision.

Additionally, the ISO has recently implemented a load forecasting model that is being adopted by load serving entities. Prior to Western making decisions on systems, and expending funds on these systems, it seems appropriate to ensure that the final option is compatible with these systems. Another one of the systems that Western is considering is the Meter Data Repository system; however, this system may not be needed given the availability of ISO direct-pollled meters on all Generating Units and interconnection points, and direct Scheduling Coordinator access to the ISO meter data system, as a service of the ISO.

III. PROPOSED DECISION DOES NOT FOLLOW WESTERN'S PUBLIC PROCESS

The Notice of Intent that was published in the Federal Register on June 24, 2003 (68 FR 37484) ("June 24th Notice") cites four alternatives to be considered by Western, namely:

1. The no-action alternative;
2. Executing a Transmission Control Agreement (TCA) and becoming a CAISO Participating TO;
3. Executing a sub-control agreement with CAISO similar to its MSS concept; or
4. Forming a Western Electricity Coordinating Council (WECC)/North American Electric Reliability Council (NERC) certified control area with the U.S. Department of the Interior, Bureau of Reclamation (Reclamation) generation and load, and certain other generation and load within the proposed control area boundary

The June 24th Notice stated "Western must select and implement one of these alternatives in a timely manner so that customers of SNR will avoid substantial business risk and uncertainty and not be subject to increased costs." June 24th Notice at 37484. Yet the Proposed Decision states "Western's proposed decision is to implement a contract-based sub-control area. Western will approach the California Independent System Operator (CAISO) and the Sacramento Municipal Utility District (SMUD) to collect data and initiate discussions to develop a contract." Proposed Decision at 67417.

The ISO was required to present a proposal to all of Western's customers and interested parties -- which it gladly did, including details of the proposal and cost analysis. The public has not been presented with any details or cost analysis of a "SMUD Alternative" so that it may have the opportunity to provide comments, either verbal or written, in accordance with the Proposed Decision. The ISO and other

members of the public must know the details of the SMUD Alternative prior to providing comments on such an alternative.

The Proposed Decision also fails to define a “contract-based sub-control area”. The June 24th Notice designates a sub-control area as “similar to its [CAISO] MSS concept”. The analyses discussed to date with the public, both by Navigant and the ISO, are based on the existing MSS concept.³ It is difficult for the ISO to comment on a “contract-based sub-control area” when the concept has not been fully defined and Western’s requirements have not been established. Additionally, the Proposed Decision does not specify a timeline for Western’s next decision, nor the criteria by which the decision will be made. Absent specific acknowledgment from Western of the criteria, the ISO hereby provides notice that it will comment on such issues once they have been clarified.

For the public to have an adequate and fair opportunity to evaluate a “SMUD contract-based sub-control area”, Western must initiate a public process and provide transparency for all participants. However, such a public process has not yet been instituted. The ISO respectfully requests that Western afford the ISO, Western’s customers, and other interested entities the opportunity to evaluate both proposals by way of a similar public process. This process should allow the opportunity for the public to clearly understand the options, question and consider the new alternative, and provide comments prior to any formal decision making by Western.

Lastly, the ISO raised substantive issues and concerns in its August 8th comments as required by the Federal Register Notice process. However, to date, the ISO has not received responses to the questions raised in its comments. Western has acknowledged that the ISO’s issues are “valid”. The ISO hopes that Western will provide responses to these issues prior to any final decision.

³ Because back-up documentation of the Navigant study has not been provided, the ISO presumes that Navigant’s analysis of the MSS is based on the existing MSS Agreements that have been filed with FERC.