SWIDLER BERLIN SHEREFF FRIEDMAN, LLP
THE WASHINGTON HARBOUR
3000 K STREET, NW, SUITE 300
WASHINGTON, DC 20007-5116
TELEPHONE (202) 424-7500
FAX (202) 424-7643
WWW.SWIDLAW.COM

NEW YORK OFFICE
THE CHRYSLER BUILDING
405 LEXINGTON AVENUE
NEW YORK, NY 10174
(212) 973-0111 FAX (212) 891-9598

August 20, 2002

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation
Docket No. ER02-2321-000

Dear Secretary Salas:

Enclosed please find the original and 14 copies of the Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Motions to Intervene, Protests, Comments, Requests for Hearing and Consolidation, Request for Clarification, and Request for Technical Conference, submitted in the above-captioned docket. Also enclosed are two extra copies of the filing to be time/date stamped and returned to us by the messenger.

Thank you for your attention in this matter.

Respectfully submitted,

David Rubin

Kenneth Jaffe
David Rubin
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Counsel for the California Independent System Operator Corporation

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket No. ER02-2321-000**

MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR TO MOTIONS TO INTERVENE, PROTESTS, COMMENTS, REQUESTS FOR HEARING AND CONSOLIDATION, REQUEST FOR CLARIFICATION, AND REQUEST FOR TECHNICAL CONFERENCE

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. §§ 385.212 and 385.213, the California Independent System Operator Corporation ("ISO")[1] hereby requests leave to file an answer, and files its answer, to the motions to intervene, protests, comments, requests for hearing and consolidation, request for clarification, and request for technical conference filed by certain intervenors in the captioned proceeding.

In support hereof, the ISO respectfully states as follows:

I. MOTION FOR LEAVE TO FILE ANSWER

Rule 213(a)(2) of the Commission's Rules of Practice and Procedure provides that answers to protests generally are not allowed "unless otherwise ordered by the decisional authority." In the past, the Commission has allowed the filing of answers to protests for various reasons demonstrating good cause. The Commission has found

[1] Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, Appendix A to the ISO Tariff, as filed on August 15, 1997, and subsequently revised.

that good cause exists when an answer will facilitate the decisional process, help resolve complex issues, clarify the issues in dispute or a party's position on the issues, lead to a more accurate and complete record, or provide useful and relevant information that will assist in the decision-making process.[2]

The ISO submits that good cause exists to grant the ISO leave to respond to the various protests filed in this proceeding. The ISO's Answer will lead to a more accurate and complete record and will assist the Commission in understanding and resolving the issues in this proceeding. For these reasons, the ISO respectfully requests that the Commission accept the following Answer.

II. ANSWER

A. Procedural Background

The ISO submitted Amendment No. 46 to the ISO Tariff on July 15, 2002. The purpose of Amendment No. 46 is to modify the ISO Tariff by amending its provisions concerning Metered Subsystems ("MSS"). The ISO filed Amendment No. 46 pursuant to a settlement agreement filed on July 15, 2002 in Docket Nos. ER01-2998-000, ER02-358-000 and EL02-64-000 ("Settlement Agreement").

Motions to intervene, protests, comments, requests for hearing and consolidation, a request for clarification, and a request for technical conference were filed by the Association of California Water Agencies ("ACWA"); the State Water Project of the California Department of Water Resources ("CDWR/SWP"); Cities of Anaheim,

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2 *East Tennessee Natural Gas Company*, 79 FERC ¶ 61,124, at 61,569 (1997); *Great Lakes Gas Transmission, L.P.*, 66 FERC ¶ 61,115, at 61,194 (1994); *Tennessee Gas Pipeline Company*, 55 FERC ¶ 61,437, at 62,306 n.7 (1994); *Transwestern Pipeline Company*, 50 FERC ¶ 61,362, at 62,090 n.19 (1980); *Transwestern Pipeline Company*, 50 FERC ¶ 61,211, at 61,672 n.5 (1980).

Azusa, Banning, Colton, and Riverside, California ("Southern Cities"); City of Redding, California ("Redding"); City of Vernon, California ("Vernon"); Modesto Irrigation District ("Modesto"); The Metropolitan Water District of Southern California ("MWD"); Sempra Energy ("Sempra"); and Turlock Irrigation District ("Turlock").[3] Additionally, the following parties submitted filings stating that they support or do not oppose Amendment No. 46: the California Electricity Oversight Board; City of Roseville, California; City of Santa Clara, California; Northern California Power Agency; and Southern California Edison Company.

B. For the Most Part, Modesto Simply Makes Arguments That It Made In Response to the Filing of the Settlement Agreement, and to Which the ISO Has Already Responded

The majority of Modesto's filing is simply a repetition of the arguments it made in the "Comments Respecting Settlement Package" it submitted on July 22, 2002 in response to the filing of the Settlement Agreement. Moreover, the comments of Redding are substantially the same as a number of the arguments made by Modesto in its filing in the present proceeding.

On August 5, 2002, the ISO provided Reply Comments to Modesto's July 22, 2002 filing ("Reply Comments"). The ISO believes it would be duplicative to repeat here the points made in the Reply Comments. Instead, the Reply Comments are attached to the present filing, and the points made therein are incorporated by reference. For the reasons described in the Reply Comments, and the other applicable reasons described

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[3] In addition, the following entities filed motions to intervene only: the M-S-R Public Power Agency; Transmission Agency of Northern California; Western Area Power Administration; and Williams Energy Marketing & Trading Company. A notice of intervention was filed by the Public Utilities Commission of the State of California. The ISO does not oppose the intervention of any of the parties that have sought to intervene in this proceeding.

in the present filing, the ISO opposes Modesto's motion to reject Amendment No. 46, as well as Redding's comment that the Commission should reject Amendment No. 46. Moreover, the present proceeding does not entail genuine issues of material fact that cannot be determined on the written record. Therefore, the ISO also opposes Modesto's alternative request for hearing in the present proceeding.

C. The Definition of MSS In Amendment No. 46 Is Reasonable

ACWA asserts that the revised definition of MSS in Amendment No. 46 should not be implemented as proposed. ACWA argues that the criteria for qualifying as an MSS should be objective and based on an entity's capability to perform rather than on the length of time an entity has been an electric utility. ACWA asks that the definition of MSS be modified by replacing the phrase "municipal utility, water district, irrigation district" with "municipal utility, water district as defined in California Water Code Section 20200." ACWA at 3-4. CDWR/SWP expresses its concern that the proposed definition of MSS would exclude CDWR/SWP because it is not an "electric utility." It states that it is inconsistent for the ISO to insist that, for purposes of contract conversion, CDWR/SWP must become a Participating TO subject to ratemaking obligations, but at the same time not allow CDWR/SWP to be a MSS. CDWR/SWP at 2.

ACWA's claim that Amendment No. 46 "narrowed" (ACWA at 1) the definition of MSS is incorrect. As shown in Attachment B to the Amendment No. 46 filing, which contain black-lined pages illustrating the changes to the existing tariff language, Amendment No. 46 did not impose a new requirement that an MSS be an electric utility that had been in operation for a number of years prior to the ISO Operations Date.[4] The amendment simply removes the requirement that an MSS be a Participating TO – an electric utility that has been operating "for a number of years," joined the ISO, and turned its facilities and Entitlements over to ISO Operational Control – and instead clarifies that an MSS only has to have been an electric utility for at least ten years prior to the ISO Operations Date. To the extent that ACWA believes that new entities should be able to qualify as MSSs, it should have raised that concern when the ISO filed Amendment No. 27 in Docket No. ER00-2019, where the requirement that an MSS be a pre-existing electric utility was established. ACWA did not protest Amendment No. 27. Accordingly, the ISO believes that ACWA's proposed modifications should be rejected. Furthermore, ACWA fails to offer a reasoned explanation as to why striking the term "water district" and replacing it with "water district as defined in California Water Code Section 20200" is not more restrictive than the simple use of water district proposed by the ISO.

Similarly, Amendment No. 46 did not modify the language from Amendment No. 27 that an MSS be a "geographically contiguous system . . . located within a single Zone." CDWR/SWP does not meet this criteria. With respect to the requirement that an entity must convert its contracts to become a Participating TO, Amendment No. 46 also did not modify this aspect of Amendment No. 27. *See* ISO Tariff, § 3.1. It is manifestly reasonable that Participating TOs be subject to ratemaking obligations as the embedded costs of their facilities and Entitlements are recovered under the ISO's transmission Access Charge and Wheeling Access Charge. In contrast, the costs of the non-converted rights of the MSS Operator are borne by the MSS Operator.

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[4] See the definition of Metered Subsystem in Appendix A to the ISO Tariff.

D. It Is Appropriate for the ISO to Include MSS Provisions in Its Tariff

Turlock asserts that the Amendment No. 46 proposal should be modified to recognize that one size does not fit all in the development and recognition of MSSs, since utilities that qualify for MSS treatment are extremely varied in their configuration, resources, and loads. For this reason, Turlock asserts, the ISO should put fewer MSS requirements in its Tariff, and leave more of those requirements to be individually tailored to each MSS in the individual MSS Agreements. Turlock at 4-5. MWD and the Southern Cities request that the Commission clarify that the MSS Agreements will not serve as boilerplate for future MSS Agreements so that such agreements can be specifically tailored to meet the special needs of future MSS Operators. MWD at 6-7; Southern Cities at 6.

As the ISO noted in its Reply Comments to Modesto's comments on the Settlement Agreement (attached to the present filing), ensuring non-discriminatory open access through a tariff of general applicability is the ISO's core mission. Moreover, the issues addressed in the proposed Amendment No. 46 – eligibility, cost responsibility, and curtailment – are not the types of issues that should be addressed in bilateral agreements. Instead, to ensure comparable treatment for all transmission customers, they are appropriately included in the ISO Tariff.

Indeed, the need to include MSS provisions in the ISO Tariff has been a requirement from the earliest days of the ISO development. *See Pacific Gas and Electric Company, et al.*, 81 FERC ¶ 61,122, 61,496 (1997). In fact, Turlock itself previously requested "the Commission to approve the concept of MSS and to require the ISO to commit to develop the MSS protocols and procedures, as provided in Section 2.5.20.3 of the ISO Tariff by January 1, 1998, or as soon thereafter as possible."[5]

With regard to the question of whether or not the agreements filed in this matter will serve as *pro forma* MSS agreements, the ISO would certainly expect that any negotiations with entities seeking to participate as MSS would proceed based on the agreements filed in this docket. However, as it has in its other *pro forma* contracts, the ISO would consider the specific circumstances of the potential new MSS and make an adjustment as appropriate. Again, as it does regularly with any Participating Generator Agreement, Utility Distribution Company Operating Agreement, or Meter Service Agreement, the ISO would discuss any significant change in its filing letter.

E. The Tariff and Agreement Strike an Appropriate Balance of Control Between the ISO and the MSS Operator

The Southern Cities express concern about the provisions that address the ISO's ability to direct the dispatch of MSS Generating Units, particularly in view of the provisions (*e.g.*, Section 3.4.2 of the Roseville MSS) that allow the ISO to seek modification of the MSS Agreement at any time. Southern Cities at 5-6. Turlock states that the Amendment No. 46 proposal requires MSSs to cede too much control to the ISO. For example, Turlock is concerned that the ISO could have control over Turlock's flood control, environmental, recreation and other operations. Turlock at 5-6. Turlock asks that the Commission require the ISO, with regard to proposed Section 23.1.1 of the ISO Tariff, to specify exactly the "applicable provisions of the ISO Tariff" with which an MSS must comply. Turlock at 6. Similarly, Turlock expresses concern that the

5 Turlock Comments in Docket Nos. EC96-19-003 and ER96-1663-003, dated September 2, 1997, at 38.

requirement in proposed Section 23.4 of the ISO Tariff that an MSS Operator must comply with all applicable Tariff provisions would enable the ISO to take control of MSS generating resources during times that are not associated with strict operational contingencies, and to do so in a way that does not recognize the existing responsibilities of multi-purpose utilities such as Turlock. Turlock at 6-7.

The concerns expressed by the Southern Cities and Turlock are unfounded. As NCPA recently stated:

> It is important not to lose sight of the fact that in the MSS Agreements, the CAISO, NCPA, SVP, and Roseville have found a means of coexisting which preserves the ability of the MSS entities to perform essential utility functions to serve their customers. These functions include the ability to follow load, to control our own generation for the benefit of our customers and the ability to protect our customers from curtailments in situations when our utilities are fully and prudently resourced and others are not because they cannot or will not pay the costs of doing so.[6]

The possibility that a transmission tariff could be modified is not a new concept. Indeed, it is incorporated in the Commission's own *pro forma* open access transmission tariff in Order No. 888.[7] A reservation of tariff modification rights is of particular importance as the industry moves to regional markets and standardized market design. If experience over the first few years of restructured electricity markets proves anything, it is that flexibility to respond to changing conditions and unforeseen developments must be preserved. Furthermore, even under a bilateral contract, the transmission provider can preserve the right to propose changes unilaterally to the Commission. Of course,

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6 Comments of NCPA in Docket No. ER02-1656-003, filed on July 19, 2002, at 3.

7 See Section 9 of the Order No. 888 *pro forma* open access transmission tariff, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. Jan. 1991-June 1996, Regs. Preambles ¶ 31,036, at 31,936 (1996) ("Order No. 888").

the Southern Cities and Turlock are not waiving in any manner their right to protest any proposed modification.

As explained in Section 2.2.1 of the ISO Tariff:

> In carrying out its functions, the ISO will comply with and will have the necessary authority to give instructions to Participating TOs and Market Participants to enable it to comply with requirements of environmental legislation and environmental agencies having authority over the ISO in relation to Environmental Dispatch and will expect that submitted Schedules will support compliance with the requirements of environmental legislation and environmental agencies having authority over Generators in relation to Environmental Dispatch.

Turlock offers no support for its accusation that Amendment No. 46 will result in problems with flood control operations. Similarly, Turlock offers no basis for differentiating its existing responsibilities as a "multi-purpose" utility from the multi-purpose utilities that have executed the Settlement Agreement and support Amendment No. 46.

F. CDWR/SWP's Proposed Language Regarding Cost Causation Is Unnecessary and Unworkable

CDWR/SWP expresses its concern that the MSS Tariff language may exacerbate the tendency of the ISO to socialize high costs to those who do not cause them, but exempt lower cost operations from the socialization. For example, CDWR/SWP asserts, even as the ISO allows MSS Operators to avoid certain ISO costs (*e.g.*, aspects of Grid Management and Neutrality Charges), the ISO continues to insist that local reliability costs such as Reliability Must Run Charges should be charged to Participating TOs and thus socialized to all Scheduling Coordinators. CDWR/SWP at 3-4. CDWR/SWP also states that proposed Section 23.16.1 would charge MSS for Neutrality Charges based only on net metered Demand and exports, while all other

Scheduling Coordinators would pay on the basis of gross metered Demand and exports and that this would violate the principles of cost causation. CDWR/SWP at 4-5. CDWR/SWP suggests that the Commission condition approval of Amendment No. 46 as follows: (a) to the extent costs are not caused by MSS Operators that are properly excused from payment, the entities identified as responsible for causing the costs should bear them; and (b) to the extent that MSS Operators are excused from payment because they have self-provided certain services, ISO costs should be reduced, and not reallocated, to all other Market Participants. CDWR/SWP at 6.

CDWR/SWP's proposed condition regarding cost causation is unnecessary and unworkable. The cost allocation provisions of Amendment No. 46 strike a careful and appropriate balance between the responsibilities of the MSS Operator and other ISO Scheduling Coordinators. The cost allocation recognizes that the MSSs have had adequate resources to meet their needs and therefore provides that since they have programs similar to the ISO's they should not have to not pay twice. An example of this is the allocation of the costs of the ISO's Summer Reliability Generation program. Due to a concern of insufficient Generation to meet the peak Demand, the ISO initiated a Summer Reliability Generation program in 2001 to increase peaking Generation in the ISO Control Area. The ISO contracted with a number of peaking units for a three-year period. The MSS Operators had already procured peaking Generation, and the MSS Operators have sufficient resources to meet their peak Demand plus planning reserves.

G. Procedural Issues

Turlock requests that the Amendment No. 46 docket be consolidated with the MSS Agreement dockets (Docket Nos. ER02-358-002, *et al.*). Turlock at 8. Vernon requests that a technical conference be held and/or the ISO be required to further explain its proposal and respond to the parties' questions before any Commission action on the Amendment No. 46 filing. Vernon at 6-7.

With respect to Turlock's request that Amendment No. 46 be consolidated with Docket Nos. ER02-358-002, *et al.*, concerning the Settlement Agreement, the ISO is hopeful that the Commission will approve both the Settlement Agreement and the implementing ISO Tariff amendment. Whether such approval is done by means of a single order in multiple dockets or two orders in separate dockets is far less important that the Commission's recognition of the hard work and collaborative effort that has brought such a diverse group of parties together.

Additionally, at least one element in the tariff amendment cannot be "refunded," if conditionally accepted for filing by the Commission. Amendment No. 46 proposes to revise the ISO's Load Shedding procedure to require Scheduling Coordinators that have made a decision not to procure resources sufficient to meet Load, if the ISO is short of resources to serve Load and maintain minimum Control Area reserves, to be the ones that would have their Load shed. These changes to the ISO's curtailment methodology are precisely those proposed by the Commission in its Standard Market Design Proposal. *See* Notice of Proposed Rulemaking in Docket No. RM01-12-000, issued on July 31, 2002, at P 478. However, if Load Shedding is required due to insufficient resources, the ISO cannot go back after the fact and modify its orders to those entities whose Load was shed. The Commission should act on and approve the amendment to avoid this and other adverse impacts on the overall Settlement Agreement.

Moreover, Vernon's request for a technical conference is wholly without merit. Indeed, it was the extraordinary series of technical conferences convened by the Commission in the PG&E proceeding that led to the filing of the Settlement Agreement. If Vernon needed more discussion regarding the proposals, it should have sought that opportunity in the prior technical conferences.

H. Other Issues

CDWR/SWP asserts that the ISO should be required to explain whether (and why) MSS Operators require special treatment, or whether existing ISO Tariff provisions could be expanded to make benefits offered to MSS Operators available more generally. It appears that CDWR/SWP has not read the Commission's audit of the ISO. In the January 2002 Operational Audit sponsored by the Commission, the auditors identified the absence of broad municipal participation in the ISO as a significant problem that needed addressing. Amendment No. 46 is intended to respond to this concern. The audit explicitly stated that "The public power sector . . . should be an integral part of any industry design that purports to optimize California's resources" and that the ISO should "[r]e-initiate efforts in future market design to bring public power into the fold of an integrated California solution."[8] The MSS proposal does this. With respect to CDWR/SWP's demand that the ISO explain why MSS Operators require special treatment, the answer is that this submission reflects the mutual agreement of a diverse group of parties reflected in the Settlement Agreement that was required to integrate municipal utilities into the "California solution" in a manner as consistent as possible with the systems, rules, and procedures of the ISO. The ISO supports the

[8] See January 2002 Operational Audit, Chapter IV, Section G.

overall balance of commitments reflected in the agreements and believes that it will provide enhanced participation in the ISO's markets, better coordinated information and operations, and fair cost allocations.

CDWR/SWP also asserts that the Commission should condition any approval of Amendment No. 46 with a requirement that the ISO must, as part of the ISO's "Market Design 2002" ("MD02") process, revise the ISO Tariff to (a) promote and facilitate nondiscriminatory self-provision of Ancillary Services, Energy and related services for *all* Market Participants, and (b) apply principles of cost causation in allocating all ISO costs for all ISO Market Participants. CDWR/SWP at 3.[9] Self-provision of Ancillary Services and Energy is a principle that has been embodied in the ISO structure since the ISO Operations Date in 1998. All Scheduling Coordinators today have the ability to self-provide those services. CDWR/SWP's assertion that this opportunity does not already exist is a plain error of fact. Even if it were not, this proceeding is not an appropriate vehicle for the imposition of conditions on the MD02 proceeding.

Sempra asks the Commission to condition approval of Amendment No. 46 so that such approval is only to the extent that (a) its provisions are fully consistent with and supportive of the Commission's Standard Market Design, and (b) its provisions do not unduly discriminate against the economic interests of Participating TOs and other Market Participants. Sempra at 4. While the Commission's Standard Market Design process has just begun, the MSS Agreements do include a re-opener provision that requires the parties to revise the agreement consistent with the new market design, whatever that may be. Nothing in Amendment No. 46 or the Settlement Agreement prejudices the ongoing market redesign activities either as part of the ISO's own MD02 process or the Commission's Standard Market Design Rulemaking. As noted above, the ISO has preserved the right in both the ISO Tariff and the MSS Agreements to propose any necessary conforming amendments pursuant to Section 205 of the Federal Power Act. In addition, Section IV.A.4 of the Settlement Agreement states that in the event the ISO modifies its market design, the parties are to meet and confer to consider whether changes to the Settlement Agreement are required. Thus, Sempra's request that the Commission condition approval of Amendment No. 46 so that such approval is only to the extent that its provisions are fully consistent with and supportive of standard market design is unnecessary.

As explained above, Amendment No. 46 does not unduly discriminate against the economic interests of Participating TOs and other Market Participants. Sempra raises no specific issue but rather requests only a general condition. Sempra at 4. This request is unnecessary, as any approved tariff is presumed not to be unduly discriminatory and is always subject to a proceeding under Section 206 of the Federal Power Act as circumstances arise that warrant modification of that tariff.

The Southern Cities find unacceptable the provision in Section 8.2.2 of the Roseville MSS Agreement that would allow the ISO to treat an MSS Generating Unit as if it were a Reliability Must Run ("RMR") Unit to meet local reliability needs without making the payments that normally flow to RMR Unit owners. Southern Cities at 5. The incorporation of this provision is a decision that Roseville made as part of the balance of benefits and burdens of the MSS Agreement. Moreover, Section 8.2.2 also states that if "Roseville notifies the ISO that it desires to participate in the RMR Unit designation process," Roseville can receive the payments that normally flow to RMR Unit owners.

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[9] The issue of cost causation was previously discussed.

Thus Roseville has full choice regarding this matter, and the Southern Cities' concern is unwarranted.

Vernon asserts that Load following by the MSS Operator should be clearly established as constituting self-supply of the Regulation needs of the MSS. Vernon states that it opposes the Amendment No. 46 filing if it is not the intent of the proposed ISO Tariff revisions that Load following by an MSS Operator constitutes self-supply of the Regulation needs of an MSS. Vernon at 6. Vernon's statement mistakenly equates self-supply of real-time Demand with provision of a separate and distinct Ancillary Service. Vernon does not give sufficient consideration to the Western Electricity Coordinating Council ("WECC") Minimum Operating Reliability Criteria with regard to the standards for Regulation. The criteria, and the ISO Tariff, require that Generation providing Regulation must respond to the Control Area operator's (i.e., ISO's) Automatic Generation Control ("AGC") signals. Load following is something entirely different.

Load following under the MSS Agreement allows the MSS Operator the ability to make its own adjustments to its Generation in real time to follow either up or down the changes in its Demand with minimum adverse financial consequences under the ISO Tariff. As recognized by the Commission in Order No. 888, Regulation is an Ancillary Service needed to follow the moment to moment variations in load in the Control Area.[10]

Amendment No. 46 specifies that an MSS Operator may operate a System Unit or Generating Units in the MSS to follow its Load if two conditions are met. First, the Scheduling Coordinator for the MSS shall remain responsible for purchases of Imbalance Energy if it does not operate its System Unit or Generating Units or schedule

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10 *See* Order No. 888 at 31,707.

imports into the MSS to match the metered Demand in the MSS and exports from the MSS. Second, if the deviation between (a) the Generation in the MSS and imports into the MSS and (b) metered Demand in the MSS and exports from the MSS exceeds a "Deviation Band" equal to 3% of the lesser of the MSS Operator's metered or Hour-Ahead scheduled Demand and exports from the MSS, adjusted for Forced Outages and any ISO directed firm Load Shedding, then the MSS Scheduling Coordinator must pay a "Deviation Price."[11]

Moreover, the MSS Operator, as does any Scheduling Coordinator under the ISO Tariff, has the right to self-supply its Regulation needs. In order to self-supply Regulation, the Generation must be on AGC to enable the ISO to engage in the "moment-to-moment" balancing of Load in the ISO Control Area, which is the exclusive responsibility of the ISO as Control Area operator. Thus Generating Units providing Regulation to the ISO are available to the ISO to respond to the area control error ("ACE") of the ISO Control Area, not the variations of an individual Load. Consequently, Load following allowed in the MSS Agreement is not self-provision of Regulation.

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[11] Proposed Section 23.12.1 of the ISO Tariff. The Deviation Price will be based on the effective weighted average *ex post* price applicable to the MSS Scheduling Coordinator for the billing interval. If the metered Generation resources and imports exceed the metered Demand and exports (and Energy expected to be delivered by the MSS in response to the ISO's Dispatch instructions and/or Regulation set-point signals issued by the ISO's AGC) by more than the Deviation Band, the MSS Scheduling Coordinator will pay the ISO an amount equal to 100% of the product of the Deviation Price and the amount of the Imbalance Energy that is supplied in excess of the Deviation Band. Proposed Section 23.12.2.1 of the ISO Tariff. If metered Generation resources and imports into the MSS are insufficient to meet the metered Demand and exports (and Energy expected to be delivered by the MSS in response to the ISO's Dispatch instructions and/or Regulation set-point signals issued by the ISO's AGC) by more than the Deviation Band, the MSS Scheduling Coordinator will pay an amount equal to the product of the Deviation Price and 200% of the shortfall that is outside the Deviation Band, in addition to the Imbalance Energy charges that may be applicable under the ISO Tariff. Proposed Section 23.12.2.2 of the ISO Tariff.

III. CONCLUSION

Wherefore, for the foregoing reasons and the reasons set forth in its Amendment No. 46 filing, the ISO requests that the Commission approve Amendment No. 46 to the ISO Tariff.

Respectfully submitted,

John Anders
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7135

Kenneth Jaffe
David Rubin
Swidler Berlin Shereff Friedman, LLP
3000 K. Street, N.W., Suite 300
Washington, D.C. 20007
Tel: (202) 424-7500

Filed: August 20, 2002

ATTACHMENT

DATE STAMP AND RETURN

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas and Electric Company	)	Docket Nos. ER01-2998-000,
	)	and ER02-358-000
Northern California Power Agency	)	
	)	
v.	)	Docket No. EL02-64-000
	)	
Pacific Gas and Electric Company and the California Independent System Operator Corporation	)))	

REPLY COMMENTS OF THE CALIFORNIA INDPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rule 602(f)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602(f)(2), the California Independent System Operator Corporation ("ISO") hereby submits its reply to the comments on the Offer of Settlement submitted by the Modesto Irrigation District ("MID"). As explained herein, MID's opposition to a portion of the comprehensive settlement package is without merit and will disrupt the ISO's implementation of the agreement. As explained below, the Commission should accept both the Offer of Settlement in the above-captioned docket and the ISO's companion filing of Amendment No. 46 in Docket No. ER02-2321-000, without modification.

The Offer of Settlement and Amendment No. 46 provide for an orderly transition for the Northern California Power Agency ("NCPA"), Silicon Valley Power ("SVP"), and the City of Roseville, California ("Roseville") from their historic interconnection agreements with Pacific Gas and Electric Company ("PG&E") to the new California marketplace and transmission regime administered by the ISO. This is accomplished by permitting these governmental entities to operate as metered subsystems ("MSS"). As NCPA has recognized, with these agreements "the CAISO, NCPA, SVP, and Roseville have found a means of coexisting which preserves the ability of the MSS entities to perform essential utility functions to serve their customers."[1]

I. BACKGROUND

In Amendment No. 27 to the ISO Tariff, the ISO proposed a new rate methodology for recovery of its transmission Access Charge.[2] Amendment No. 27 also included provisions to enable New Participating TOs to qualify as MSSs to facilitate their continued operation as vertically integrated utility systems while also providing an alternative way to participate in the ISO's markets and to use the ISO Controlled Grid for transactions with their surplus resources. These changes were reflected in Section 3.3 of the ISO Tariff. The Commission accepted Amendment No. 27 subject to refund and hearing and suspended the hearing pending settlement procedures. These settlement proceedings are ongoing.

Following the Amendment No. 27 filing, only one governmental entity, the City of Vernon, California, has joined the ISO as a Participating Transmission Owner.[3] In the January 2002 Operational Audit sponsored by the Commission, the auditor identified the absence of broad municipal participation in the ISO as a significant problem that needed

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1 Comments of NCPA in Docket No. ER02-1656-003 filed on July 19, 2002 at p. 3.

2 Capitalized terms not otherwise defined herein have the meaning conained in the Master Definition Supplement, Appendix A to the ISO Tariff.

3 Although recently, four additional governmental entities: the Cities of Anaheim, Azusa, Banning and Riverside, California have filed Notices of Intent to become Participating Transmission Owners effective January 1, 2003.

addressing. As explained below, the MSS agreements with NCPA, SVP, and Roseville, coupled with the recent applications of four municipal utilities to become Participating Transmission Owners, demonstrate that the ISO has made significant strides in this direction.

On August 30, 2001, PG&E filed a Notice of Termination of the Interconnection Agreement ("IA") dated September 14, 1983 among it and the NCPA and ten of its member utilities, including the City of Roseville, and a proposed replacement Interconnection Agreement among PG&E, NCPA and nine of NCPA's member utilities.[4] On November 16, 2001, PG&E filed a Notice of Termination of the 1983 Interconnection Agreement between it and the City of Santa Clara's electric utility, SVP, and a proposed replacement Interconnection Agreement ("RIA") between PG&E and SVP. On February 27, 2002, NCPA filed an Emergency Petition For Declaratory Order against PG&E and the ISO seeking, among other relief, a technical conference to resolve disputed issues regarding ongoing contractual rights under agreements other than the current NCPA IA and operational questions related to the change to ISO Tariff requirements.

On March 14, 2002, the Commission issued an order conditionally accepting the Notices of Termination and the RIAs, suspending their effectiveness until September 1, 2002. That order directed that a technical conference be held to resolve issues regarding the effect of terminating the current NCPA IA and the current SVP IA on other agreements involving transmission service to NCPA, Roseville and SVP.

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[4] Since Roseville is connected to the Western Area Power Administration and not PG&E, the replacement IA does not include Roseville.

Through the extensive efforts of all parties and greatly facilitated by Commission staff, the parties to these proceedings were able to reach a comprehensive settlement. Section IV.E.5 of the Offer of Settlement states:

> The Parties recognize that the ISO will, concurrent with the filing of this Settlement Agreement, make a filing pursuant to Section 205 of the Federal Power Act with FERC of the NCPA MSS Aggregator Agreement ..., the Roseville Metered Subsystem Agreement ..., the SVP Metered Subsystem Agreement ..., and the revised ISO Tariff language reflecting the changes in MSS terms and conditions.... The Parties to this Settlement Agreement agree to support or not oppose a filing that incorporates the ISO Tariff provisions and agreements in the form attached; however, the Parties may intervene and participate in any FERC or appellate proceeding regarding this filing.

To fully incorporate those changes, the ISO made a filing on July 15, 2002 in Docket No. ER02-2321 consisting of the proposed ISO Tariff amendments needed to implement the MSS agreements; the NCPA MSS Aggregator Agreement; the City of Roseville Metered Subsystem Agreement; and the Silicon Valley Power Metered Subsystem Agreement.

II. ARGUMENT

A. MID Has Not Raised an Issue of Material Fact that Could Prevent Commission Consideration of the Offer of Settlement.

Under Rule 602(f) of the Commission's Rules of Practice and Procedure, 18 C.F.R.§ 385.602(f)(4), a party contesting an Offer of Settlement by alleging a dispute as to a genuine issue of material fact, "must include an affidavit detailing any genuine issue of material fact." MID neither demonstrated the existence of a genuine issue of material fact nor included such an affidavit. Its opposition to the Offer of Settlement therefore does not render the settlement contested within the meaning of the Commission's rules. Rather, MID's opposition is based solely on policy grounds. The Commission has held that, if a party's opposition to a proposed settlement concerns a matter of policy, it can resolve the matter without development of a record. *Koch Gateway Pipeline Co.*, 74 FERC ¶ 61,088, 61,270-71 (1996). Accordingly, MID's comments do not prevent Commission consideration and acceptance of the Offer of Settlement.

B. The ISO's Tariff Amendment Is a Necessary and Proper Means To Effectuate the Agreements Allowing NCPA, SVP, and Roseville To Transition From Their Historic Interconnection Agreements To the New ISO Market Structure While Still Protecting Their Core Interests.

The Offer of Settlement resolved a number of difficult transitional issues concerning the termination of the IAs that existed prior to the formation of the ISO and the need to accommodate the business practices of these governmental entities within the framework of the new market and the transmission service protocols. It is the result of enormous efforts on the part of the Commission staff to facilitate a mutually acceptable outcome. That the Offer is an appropriate compromise is reflected by the fact that it is supported by the affected investor owned utility, PG&E, as well as NCPA, SVP, Roseville, and the ISO.

Most importantly, the settlement is a comprehensive package and the ISO's filing of a tariff amendment to implement the agreement is a necessary and proper means to effectuate the agreement. In accordance with the Section IV.A.1. of the Offer, "This Settlement is contingent upon Commission acceptance of ... the NCPA MSS Aggregator Agreement, the SVP Metered Subsystem Agreement, the Roseville Metered Subsystem Agreement, and the Metered Subsystem-related provisions of the ISO Tariff."

The ISO Tariff must be amended to effectuate the parties' intent as expressed in the Offer of Settlement. For example, under the existing ISO Tariff Section 3.3, only a New Participating TO could qualify as an MSS. Under the proposed amendment, any entity that is determined by the ISO to qualify as an MSS and that undertakes in writing to comply with the applicable provisions of the ISO Tariff shall be considered an MSS Operator and shall have the rights and obligations set forth in a revised Section 23 of the ISO Tariff. (Section 23.1.1)

The tariff amendments also specify the cost responsibilities of the MSS. The ISO will assess the MSS Scheduling Coordinator ("SC") the neutrality adjustments and Existing Contracts cash neutrality charges pursuant to Section 11.2.9 (or collect refunds therefor) based on the net metered Demand and exports of the MSS. (Section 23.15.1) If the ISO is charging SCs for summer reliability or demand programs, the MSS Operator may petition the ISO for an exemption from these charges provided the MSS Operator can show that it has its own peaking and/or demand programs. The ISO will grant an exemption from these charges if the MSS Operator demonstrates by November 1 that it has secured generating capacity[5] for the following year at least equal to 115% of the peak Demand responsibility of the MSS Operator.[6] (Section 23.15.2). If the ISO is compensating Generating Units for emissions and start-up costs, and if an MSS Operator charges the ISO for the emissions and start-up costs of the MSS's Generating Units serving the Load of the MSS, then the MSS Scheduling Coordinator shall bear its proportionate share of the total amount of those costs incurred by the ISO based on the MSS gross metered Demand and exports, and the Generating Units shall be made available to the ISO through the submittal of Supplemental Energy bids. If the

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5 Eligible generating capacity for such a demonstration may include on-demand rights to Energy, peaking resources, and Demand reduction programs.

6 The peak Demand responsibility of the MSS Operator equals the annual peak Demand Forecast of the MSS Load plus any firm power sales by the MSS Operator, less interruptible Loads, and less any firm power purchases.

MSS Operator chooses not to charge the ISO for the emissions and start-up costs of the MSS's Generating Units serving its Load, the MSS SC will bear its proportionate share of the total amount of those costs incurred by the ISO based on the MSS's net metered Demand and exports. The MSS Operator must make the election whether to charge the ISO for these costs on an annual basis on November 1 for the following calendar year. (Section 23.15.3). The MSS SC will be responsible for transmission losses only within the MSS, at any points of interconnection between the MSS and the ISO Controlled Grid, and for the delivery of Energy to the MSS or from the MSS, provided the MSS Operator fulfills its obligation to provide for transmission losses on the transmission facilities forming part of the MSS. (Section 23.15.4) For internal Generation serving internal Load, the ISO will be using a GMM of 1.0. If internal Generation is used to serve Load outside the MSS boundary, then the ISO will assign a GMM in accordance with the ISO Tariff requirements.

Additionally, the proposed tariff amendment addresses a concern in California regarding blackouts needed solely because one or more Scheduling Coordinators have made an economic decision not to procure sufficient resources to meet their Load responsibility and the ISO's BEEP stack is insufficient to meet all of the Control Area needs. Thus, a distinction will be made between System Emergencies associated with an entity's resource deficiency or failure to maintain an Approved Credit Rating, and System Emergencies associated with operational contingencies, which will be set forth in part in the agreements and in part in proposed ISO Tariff amendment provisions. The agreements will provide that a UDC or MSS will not be obligated to shed Load or commit excess generating capacity or Energy in the case of System Emergencies associated with an entity's resource deficiency or failure to maintain an Approved Credit Rating, subject to compliance with market mitigation requirements. Thus, this addition impacts the entire Control Area, not just the new MSSs.[7] The ISO Tariff amendment provisions provide that if the ISO must curtail Load, and an entity is short of resources to serve its Load because it did not procure sufficient resources, then only that entity will be required to shed Load. The ISO's filing letter in Docket No. ER02-2321 more fully discusses the scope and basis of the proposed tariff modifications.

C. The Specific Concerns Raised by MID Are Without Merit

1. MID's Insistence that the ISO Must Proceed By Means of Bilateral Contracts Instead of Generally-Applicable Tariff Requirements Should Be Rejected

MID argues that "generically imposing ISO Tariff rules is unnecessary and harmful to the market." MID Comments at 3. This contention fundamentally misperceives the function of the ISO Tariff. Ensuring non-discriminatory open access through a tariff of general applicability is the ISO's core mission. Moreover, the issues addressed in the proposed tariff amendment -- eligibility, cost responsibility, and curtailment -- are not the type of issues that should be addressed in bilateral agreements. Instead, to ensure comparable treatment for all transmission customers, they are appropriately included in the ISO Tariff.

Furthermore, MID's cite to the recent D.C. Circuit case[8] as a limit on the Commission's authority to require uniformity is inapposite. In this instance, the

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7 Currently the ISO has 8 UDCs, consisting of PG&E, Edison, SDG&E, Vernon, Anaheim, Riverside, Pasadena, and Lassen.

8 MID comments at 4 citing *Atlantic City Electric Co. v. FERC*, No. 97-1097 (D.C. Cir., Decided July 12, 2002.

Commission is not imposing uniformity on regulated public utilities. To the contrary, it is the ISO -- the regulated public utility with the Section 205 filing rights, that is proposing to employ uniform rules, as set forth in its tariff, to provide assurances to transmission customers that they will not suffer undue discrimination. Nothing in the D.C. Circuit's decision, or any other appellate ruling, limits the ability of a regulated public utility to propose and implement tariff provisions for that purpose. Additionally, with the Commission's recent rule making on Revised Public Utility Filing Requirements, Order No 2001, 67 FR 31043 FERC ¶ 31,127, the Commission is moving to a paradigm of standard agreements where terms and conditions are included in a public utilities' tariff and bilateral contracts are replaced by *pro forma* service agreements.

2. <u>MID Appears More Intent on Repeating Its Old Protests Regarding the ISO's Amendment No. 27 Filing Without Recognizing the Actions the ISO has Taken To Address Its Concerns</u>

MID is correct that the ISO is significantly modifying the MSS provisions filed in Amendment No. 27. However, MID's contention that the combination of approval of the Offer of Settlement and Amendment No. 46 could prejudice their protest of Amendment No. 27 is groundless. MID Comments at 10. There is nothing in the Federal Power Act or the Commission's regulations or precedents that precludes a public utility from presenting revised proposals that address concerns raised about previous, pending tariff amendments. MID appears more concerned with rehashing its protest to Amendment 27 than in recognizing the additional accommodations the ISO has made to facilitate the participation of governmental entities.

Although Amendment No. 27 was submitted following an extensive stakeholder process, the ISO agrees that the MSS provisions in Amendment 27 were not a "consensus product." MID Comments at 7. Amendment No. 46, however, *is* explicitly incorporated in the Offer of Settlement supported by a broad coalition of municipal utilities as well as an investor owned utility. The Offer of Settlement and the companion ISO Tariff amendments demonstrate that the ISO has worked with interested parties to develop an effective means of addressing the concerns of municipal utilities.

MID's complaint that Amendment No. 27 "failed to accommodate the special needs of municipal utilities" (MID Comments at 7) is thus beside the point. The subject of the instant proceedings is not Amendment No. 27 but Amendment No. 46 and the Offer of Settlement. That package has the overwhelming support for the affected entities. As NCPA recently stated:

> It is important not to lose sight of the fact that in the MSS Agreements, the CAISO, NCPA, SVP, and Roseville have found a means of coexisting which preserves the ability of the MSS entities to perform essential utility functions to serve their customers. These functions include the ability to follow load, to control our own generation for the benefit of our customers and the ability to protect our customers from curtailments in situations when our utilities are fully and prudently resourced and others are not because they cannot or will not pay the costs of doing so.[9]

Similarly, MID's complaint that Amendment No. 27 required municipal utilities to "convert" their existing transmission contracts and "join" the ISO to obtain MSS status (MID Comments at 7) fails to acknowledge is that the Amendment No. 46 and the Offer of Settlement do *not* include this requirement. The current proposal thus accommodates concerns expressed by MID and others regarding this aspect of Amendment No. 27. MID's repetition of this objection to the earlier proposal plainly presents no basis for rejecting Amendment No. 46 or the Offer of Settlement.

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9 Comments of NCPA in Docket No. ER02-1656-003 filed on July 19, 2002 at 3.

MID also contends that governmental entities, like other market participants, would be subject to service under a contract that has the potential to be modified after FERC approval, pursuant to Section 205. MID Comments at 7. The possibility that a transmission tariff could be modified is not a new concept. Indeed, it is incorporated in the Commission's own pro forma open access tariff in Order No. 888.[10] A reservation of tariff modification rights is of particular importance as the industry moves to regional markets and standardized market design. If experience over the first few years of restructured electricity markets proves anything, it is that flexibility to respond to changing conditions and unforeseen developments must be preserved. Furthermore, even under a bilateral contract, the transmission provider can preserve the right to propose changes unilaterally to the Commission. MID incorrectly presumes that the ISO would waive these Section 205 rights in a bilateral contract.

With regard to MID's principles (MID Comments at 8-10),[11] the ISO notes:

(1) The revised MSS program accomplishes Principle 1 by allowing the MSS to remain vertically integrated and not requiring ETC conversion.

(2) The amendment reaches an accommodation on which charges should be charged on a net basis and which should be assessed on a gross basis. MID's position that all charges should be net (MID Comments at 9) has been expressly rejected by the Commission.[12]

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[10] See Section 9 of the Order No. 888 *pro forma* tariff.

[11] These principles are as follows: (1) The form of the MSS shall reflect the right of the publicly owned utility to operate as a full service utility within the ISO's control area; (2) all ISO charges should be on a net basis; and (3) the amount of MSS resources available to the ISO shall be limited to the amount of MSS resources actually reserved by the ISO for that time.

[12] See, for example, the Commission's order of May 15, 2002,

> We will deny intervenors request for rehearing that the Commission erred in its decision to accept Control Area Gross Load as a billing determinant. As we stated in the December 19 Compliance Order, the use of total gross load is the most appropriate method to assess emissions and start-up costs because all users of the transmission grid

(3) The revised MSS program accomplishes Principle 3.

MID's only remaining concerns appear to be that the MSS Operator must comply with the ISO Tariff as it may be amended, following Commission approval, from time to time and that MID will have to have its resources "processed through the ISO Markets". MID Comments at 11 and 12. As noted above, the possibility that a transmission tariff could be modified is not a new concept and that a reservation of tariff modification rights is of particular importance given the ongoing market redesign and market standardization activities. With regard to MID's protest that the agreement requires resources -- even self-supply -- to be processed through the ISO market, the ISO disagrees that the ISO Tariff impairs, in any way, MID's or any other entities' ability to meet its responsibilities under or receive the benefits of bilateral transactions.

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will be assigned these costs consistent with ISO markets performing a reliability function. *San Diego Gas and Electric Company, et al.*, 99 FERC ¶ 61,159, slip op. at 12-13.

III. CONCLUSION

Wherefore, for the foregoing reasons, the ISO respectfully requests that the Commission reject MID's comments and accept both the Offer of Settlement in the above-captioned docket and the ISO's companion filing of Amendment No. 46 in Docket No. ER02-2321-000, without modification.

Respectfully submitted,

John C. Anders
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7135

David Rubin
Swidler Berlin Shereff Friedman, LLP
3000 K. Street, N.W., Suite 300
Washington, D.C. 20007
Tel: (202) 424-7500

Counsel for the California Independent
System Operator Corporation

Date: August 5, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents upon each person designated on the official service list compiled by the Secretary in this proceeding, in accordance with Rule 385.2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, D.C., on this 5th day of August, 2002.

David B. Rubin

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents upon each person designated on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with Rule 385.2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, D.C., on this 20th day of August, 2002.

David B. Rubin

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