

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

California Independent System Operator)
Corporation)

Docket No. ER02-2046-000

**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION TO
MOTIONS TO INTERVENE AND PROTESTS**

On May June 6, 2002, the California Independent System Operator Corporation ("CA ISO") filed with the Federal Energy Regulatory Commission (the "Commission") an unexecuted associated Meter Service Agreement ("MSA") (and associated Participating Generator Agreement ("PGA")) between the CA ISO and the Valero Refining Company – California ("Valero") pursuant to Section 205 of the Federal Power Act. The MSA applies to Valero's Cogeneration Unit at Valero's petroleum refining facility in Benicia, California ("Cogeneration Unit #1"). Valero and the Cogeneration Association of California ("CAC") sought leave to intervene in this proceeding. Valero protested the unexecuted MSA. The CA ISO does not oppose the motions to intervene of Valero and CAC.

The issues raised in Valero's protest do not provide a basis for dismissal of the unexecuted MSA.¹ Valero seeks to interconnect to the CA ISO Controlled Grid and to garner the benefits of interconnected operations. In this context,

¹ Although the Commission's Rules do not allow for answers to protests, the Commission has discretion under Rule 385.213 (a)(2) to allow answers for good cause. In this instance, the ISO avers that its answer will be helpful to the Commission in assessing Valero's contention that it should not be required to sign a PGA.

Valero must sign a PGA, and associated MSA and comply with applicable CA ISO Tariff requirements. As to the appropriate terms of the MSA, if the Commission finds that Valero must sign an MSA, both the CA ISO and Valero have indicated agreement to be bound, subject to the right of appeal, by the Commission order in Docket No. ER98-997 where the particular considerations associated with Qualifying Facilities ("QFs") have been amply litigated.

I. Background.

The background associated with Valero is set forth in full in the CA ISO's June 6 transmittal letter but for the Commission's convenience is summarized here. Valero interconnected and intends to operate Cogeneration Unit #1 at Valero's petroleum refining facility in Benicia, California. Cogeneration Unit #1 has a nominal rating of 47.729 MW and is interconnected at the 230 kV bus connecting the Vaca-Dixon line to the Moraga line. Valero has indicated that the output of Cogeneration Unit #1 will be dedicated to meet Valero's load of approximately 50 MW at the Benicia facility. Valero has indicated that it intends to continue to purchase its net requirements at the Benicia facility from Pacific Gas and Electric Company ("PG&E") under Tariff Schedule E-20T and Schedule S.

When it became aware of the intended interconnection of Cogeneration Unit #1, the CA ISO contacted Valero communicating CA ISO requirements for Participating Generators. Discussions followed but ultimately the CA ISO and Valero were not able to reach agreement as to the applicability of CA ISO requirements, including the requirement that Valero sign a PGA, and associated

MSA, with the CA ISO. To facilitate interconnection pending resolution of these disagreements, Valero agreed to provide the CA ISO with certain information that the CA ISO requires to maintain the reliability of the CA ISO Controlled Grid pending a Commission decision on disputed legal issues. The CA ISO and Valero reached a full agreement on May 24, 2002 ("May 24 Agreement").

In the May 24 Agreement, the CA ISO and Valero reserved their respective positions as to whether Valero is required to sign a PGA and associated MSA, and the form of these agreements, and agreed that these legal issues could be submitted to the Commission for its determination. In the interim, Valero agreed to coordinate with the CA ISO as to certain fundamental reliability matters including providing gross telemetry to the CA ISO², scheduling outages with the CA ISO, responding to CA ISO operating instructions to alleviate System Emergencies and other conditions adversely affecting the reliability of the CA ISO Controlled Grid, and complying with applicable standards and agreements of the Western Electricity Coordinating Council ("WECC"). In turn, the CA ISO agreed to drop its opposition to interconnection by Valero and to use all commercially reasonable efforts to facilitate such interconnection. Consistent with the May 24 Agreement, the CA ISO then filed an unexecuted PGA and associated MSA with the Commission.

II. Valero is required under the CA ISO Tariff to sign a PGA and associated MSA.

Since the parties have agreed to be bound, subject to the right of appeal, by the MSA terms adopted in a Commission order in Docket No. ER98-997, the

fundamental issue to be determined by the Commission as to the Valero unexecuted MSA, is whether a facility seeking to interconnect to the CA ISO Controlled Grid and to garner the benefits to interconnected operations should be required to sign a PGA, and associated MSA with the CA ISO. The CA ISO considers that the CA ISO Tariff, public policy and reliability considerations require that the answer to this question be an unequivocal yes.

Valero argues that it is not required, in accordance with the CA ISO Tariff to sign a PGA or associated MSA because it does not wish to participate in CA ISO markets. Valero contends further that Section 5 of the CA ISO Tariff only requires that a Generator agree to comply with the CA ISO Tariff before the CA ISO is obligated to accept Schedules or Adjustments bids or bids for Ancillary Services from that Generator. Valero stresses repeatedly that it has no interest in participating in the CA ISO's Energy and Ancillary Service markets.

The CA ISO accepts for purposes of this discussion that Valero does not wish to participate actively, i.e. submit bids, in the CA ISO's Energy and Ancillary Service markets. This determination does not end the matter, however. The CA ISO requires the information on all generating units in its Control Area to reliably operate the Control Area in accordance with WECC and NERC standards. As explained in the CA ISO's June 6th transmittal letter in this matter, the CA ISO's position that Valero must sign a PGA, and associated MSA, stems from the fact that Valero must, consistent with CA ISO Tariff metering requirements, meter the gross output of Cogeneration Unit #1; and to avoid significant Imbalance Energy charges, Valero must schedule the output of Cogeneration Unit #1 consistent

² Gross telemetry is defined as the telemetry on the Generating Unit and the telemetry at the site boundary.

with such metering or on a gross basis. Thus, to avoid Imbalance Energy charges, Valero must Schedule the output of Cogeneration Unit #1 with the CA ISO.

CA ISO Tariff section 5 is clear that before entities can Schedule over the CA ISO Controlled Grid they must undertake in writing to abide by the CA ISO Tariff. The PGA is the pro-forma tool that has been developed in order to have one consistent "writing" by which generators agree to abide by the CA ISO Tariff. In fact, the PGA contains little substance other than a commitment on the part of a subject Generator to abide by the CA ISO Tariff.

This same analysis applies with regards to the language of the PGA quoted by Valero which also references a desire to Schedule Energy. Of course, a PGA with the CA ISO can be terminated if a Generator intends to cease operations and hence would neither Schedule Energy nor participate in CA ISO markets.

The CA ISO notes moreover that it is undisputed that Valero intends to rely on the interconnected electricity system to provide balancing power to augment the power produced by Cogeneration Unit #1. Valero concedes that it will purchase its net power requirements and standby service from PG&E. See Motion to Intervene, Protest, and Motion to Reject of Valero Refining Company-California at 5. This balancing is provided through the interconnected grid which, as described in the CA ISO's June 6 transmittal letter in this matter, responds automatically in the event of power fluctuations from the unit. The requirements for gross metering and gross Scheduling provide the basis by which the CA ISO

can monitor and control the balancing function that Valero seeks to avail itself of, and thus maintain reliability of the entire CA ISO Control Area.

In sum, a Generator over 1 MW such as Valero is subject to the gross metering requirement in the CA ISO Tariff and, to avoid Imbalance Energy charges, must Schedule on a gross basis as well. To obtain the right to Schedule over the CA ISO Controlled Grid, the Generator must undertake in writing to comply with the CA ISO Tariff, i.e. must sign a PGA, the pro forma agreement approved by the Commission to meet the requirements of section 5. Participating Generators (as well as Generators directly connected to the CA ISO Controlled Grid) are CA ISO Metered Entities, CA ISO Tariff, Appendix A, Master Definitions Supplement, and require an MSA.

III. A Failure by Valero to Sign a PGA, and associated MSA, Would Have Adverse Reliability Impacts.

As set forth in the CA ISO's June 6 transmittal letter, a failure by Valero to agree to abide by CA ISO Tariff requirements by signing a PGA does indeed create reliability concerns. ; The CA ISO Automatic Generation Control (AGC) application within the CA ISO Energy Management System (EMS) responds automatically to fluctuations in Load and Generating Unit output by sending signals to Generating Units that have successfully bid regulation into the CA ISO Day Ahead, Hour Ahead or Supplemental Energy Ancillary Service markets. In the case of Valero, these fluctuations involve Cogeneration Unit #1, a sizeable (approximately 50 MW) facility interconnected directly to the CA ISO Controlled Grid. Fluctuations in operations, and scheduled and unscheduled outages of

Cogeneration Unit#1 has the potential to substantially affect system operations on the CA ISO Controlled Grid in the Benicia area. Without having information on scheduled and unscheduled outages and on the real time status (through scheduling and telemetry) of Cogeneration Unit #1, the CA ISO will nevertheless have to respond to significant swings in Control Area Load and Generation in the Benicia area without advance notice or after-the-fact knowledge of what is causing or has caused the swings.

Moreover, the CA ISO notes that while Valero claims that it is installing a megawatt control system that will regulate the output of plant, the system is not yet in place and no details have been provided in Valero's protest about the system or the time frame for its installation. The May 24, 2002, Agreement conditions the temporary exemption from gross revenue metering on immediate notice by Valero to the CA ISO in the event of delivery of net Generation to the CA ISO Controlled Grid, so clearly this circumstance was known to be a possibility. See May 24, 2002 Agreement footnote 1. In any event, such a system would not prevent a sudden appearance of load on the system when Cogeneration Unit #1 ceases to operate.

Further, Valero's contention that there are no reliability concerns because Valero has agreed to provide the CA ISO with certain key information including telemetry, Schedules and outage information is disingenuous since the May 24, 2002 Agreement which sets forth these commitments expires, by its terms, upon issuance of "(1) a final, unappealable decision arising from the FERC determination of whether a PGA and associated MSA must be executed by

Valero, or similarly situated Generators and (2) a final, unappealable decision in Docket No. ER98-997 ..."

From the CA ISO's standpoint, the May 24, 2002 Agreement addresses the most important reliability issues associated with the interconnection of Cogeneration Unit #1 pending a Commission determination regarding the applicability of a PGA. However, since it would terminate upon a final decision that a PGA does not apply, it is not appropriate to rely on the Agreement to address the fundamental reliability issues associated with interconnection by Cogeneration Unit #1 to the CA ISO Controlled Grid.³

Further, if the Commission were to determine that for facilities such as Valero the terms of the May 24, 2002 Agreement are sufficient, the terms should be made mandatory and applicable to all similarly situated Generators that seek to interconnect to the CA ISO Controlled Grid. This is because the May 24, 2002 Agreement sets forth minimum requirements for the CA ISO to maintain reliability in the context of a significant Generating Unit interconnecting directly to the CA ISO Controlled Grid. Nonetheless, Valero has made no commitment to continue to abide by the May 24, 2002 Agreement upon its termination. Moreover, reliance on voluntary agreements could be discriminatory and further compromise the reliability of the CA ISO Control Area to the extent that other Generators refuse to enter into a similar agreement upon interconnection to the CA ISO Controlled Grid.

³ While theoretically, the CA ISO could have chosen not to file an unexecuted PGA for Valero and hence to have made one of the conditions precedent to termination of the agreement impossible to bring about, such a strategy would have had the result of making available to one Generator special terms rather than insisting upon consistent treatment among Generators.

Finally, the CA ISO notes that the May 2002 Agreement does not address metering requirements, other than to grant Valero a temporary exemption from the CA ISO's gross metering requirements. Accordingly, without a PGA and associated MSA there would be no mechanism to enforce against Valero the CA ISO's metering requirements. It would be inappropriate to create a category of Generating Units directly connected to the CA ISO Controlled Grid, for which no CA ISO Tariff metering requirements applied.

In sum, Valero is correct that the May 24, 2002 Agreement addresses the most fundamental reliability issues associated with its interconnection to the CA ISO Controlled Grid, in a context where Valero refused to acknowledge the applicability of the CA ISO Tariff requirements. However, since the Agreement by its terms would terminate upon final decisions regarding whether a PGA is required and the terms of such PGA, the Agreement is not an adequate substitute for an effective PGA. Moreover, the May 24, 2002 Agreement does not address metering requirements, other than to temporarily exempt Valero from application of the CA ISO's gross metering requirements, and hence is not adequate substitute for the MSA.

IV. The PGA Respects Valero's Operational Limitations.

Valero argues that requiring Valero to sign a PGA (and hence an associated MSA) for Cogeneration Unit #1 would adversely affect its ability to operate as an integrated and crucial part of Valero's refining operations. However, Valero's operational limitations are recognized in Schedule 1 of the unexecuted PGA. Moreover, the CA ISO and Valero agree that terms of the

unexecuted PGA are subject to the outcome of Docket. No.ER98-997 in which the operational concerns raised by Valero have been amply litigated.

Schedule 1 of the unexecuted PGA includes a Section 2 that sets forth 8 operational limitations that result from the operation of Cogeneration Unit #1 as an integrated and crucial part of Valero's refining operations. Schedule 1 was negotiated as part of the May 24, 2002 Agreement and sets forth a number of important limitations including, in Valero 8, a statement that Valero need not comply with CA ISO operating instructions that are inconsistent with the limitations, including instructions that would require Valero to reduce electric Energy and steam deliveries by Unit #1 to the refinery below the refinery's then current requirements. Schedule 1 thus exempts Valero from responding to CA ISO Dispatch orders that would adversely affect its industrial processes. Moreover, Schedule 1 is a permanent and integral component of the unexecuted PGA.

Further, the concerns raised by Valero regarding potential conflicts between CA ISO Tariff requirements and the operational circumstances of QFs including cogeneration facilities have been amply litigated in Docket No. ER98-997. Both Valero and the CA ISO agree that they should be bound by the outcome of Docket No. ER98-997 with regards to the PGA terms that should ultimately apply to Valero. In fact, Valero states in its protest that it is a party to Docket No. ER98-997 through its membership in the Energy Producers and Users Coalition. An initial decision in Docket No. ER98-997 is pending before the full Commission. Thus, if the Commission is persuaded that there are

conflicts between CA ISO Tariff requirements and the operational circumstances of QFs, the Commission should promptly issue a decision in Docket No. ER98-997 to address these conflicts for all QFs.

In sum, Schedule 1 to the unexecuted PGA with Valero ensures that the PGA will not adversely impact the ability of Cogeneration Unit #1 to operate in an integrated fashion with the Valero's industry processes. Any remaining concerns about the unexecuted PGA and MSA have been presented to the Commission in Docket No. ER98-997 and can (and should) be addressed in that docket.

V. The CA ISO's Waiver Request is Not Inconsistent With the May 24, 2002 Agreement.

Valero argues that waiving the sixty-day notice provision is inconsistent with the term of the May 24, 2002 Agreement. The CA ISO disagrees. Valero is correct that the May 24, 2002 Agreement terminates only upon issuance of final decisions on the applicability of a PGA and associated MSA to Valero and the terms of such PGA and MSA. However, the May 24, 2002 Agreement also specifically provides that the CA ISO may file an unexecuted PGA and associated MSA with the Commission, provided that any such filing includes the agreed upon Schedule 1, incorporates the May 24, 2002 Interim Agreement, and includes a stipulation by the CA ISO that it will abide by the terms of the May 24, 2002 Agreement. Further, the May 24, 2002 Agreement requires that the CA ISO not oppose Valero's interconnection, and to extend to Valero a temporary exemption from the CA ISO's Tariff provisions requiring gross metering. The CA ISO has met all of these commitments.

The May 24, 2002 Agreement does not state anything with regards to an effective date for the unexecuted PGA and associated MSA. In fact, if the Agreement had included language stating that the unexecuted PGA and associated MSA would not be in effect during the pendency of proceedings before the Commission, the temporary exemption from the CA ISO gross metering requirements would not have been necessary because there would have been no mechanism to make the CA ISO gross metering requirements applicable to Valero in the interim.

In sum, the CA ISO has met its commitments under the May 24, 2002 Agreement, and reiterates its request for a waiver of the Commission's sixty day filing requirement.

VI. Requiring Valero to Sign a PGA and associated MSA will Not Lead to Reduced Investment in Reliable Generation.

Valero argues that requiring Valero to sign a PGA and associated MSA will discourage investment in Generation. This argument could be made for any federal, state or CA ISO Tariff requirement applicable to a Generating Unit. However, certain requirements are necessary to ensure reliable operation of the interconnected transmission system, not only in California, but in the entire Western Interconnection. In approving the CA ISO's Tariff requirements for Generators, the Commission has already balanced burden on Generators against the critical importance of reliable interconnected operations. The question of whether there are further adjustments needed to address the particular circumstances of QFs is already before the Commission in Docket No.

ER98-997 and will undoubtedly be carefully weighed by the Commission in making a decision in that case.

However, simply exempting Generators from requirements needed to maintain grid reliability because they may be viewed as burdensome by some generators is more likely to be detrimental to investment in generation in the long term than putting in place the requirements and agreements necessary to support reliable operations. Unreliable operations of the interconnected grid, which in and of itself would be detrimental to the continued safe and reliable operation of any Generating Unit, is unlikely to encourage investment in generation interconnected to the grid.

VII. Conclusion.

For the reasons set forth in the CA ISO's June 6 transmittal letter in this matter and set forth herein, the CA ISO urges the Commission to accept the unexecuted MSA for Valero.

Respectfully submitted,

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Date: July 12, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, California this 12th day of July, 2002.

Jeanne M. Solé
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July 12, 2002

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

Re: California Independent System Operator
Docket No. ER02-2046-000

Dear Secretary Salas:

Enclosed for electronic filing in the above-captioned proceeding is the Answer of the California Independent System Operator Corporation to Motions to Intervene and Protests.

Thank you for your attention to this matter.

Respectfully submitted,

Jeanne M. Solé
Counsel for the California Independent
System Operator Corporation