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June 11, 2001

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: California Independent System Operator Corporation; Docket Nos. EL00-95-030, EL00-98-029, and ER00-1877-000

Dear Secretary Boergers:

Enclosed please find an original and fourteen copies of the Answer of the California Independent System Operator Corporation to Protests and Comments on Amended and Restated Bylaws. 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 assistance.

Respectfully submitted,

Theodore J. Paradise
Theodore J. Paradise, Esq.

Counsel for the California
Independent System Operator Corporation

010613-0206-1

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation)	Docket Nos.	EL00-95-030
)		EL00-98-029
)		ER01-1877-000
)		

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 FEDERAL ENERGY
 REGULATORY COMMISSION

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO PROTESTS AND COMMENTS ON AMENDED AND RESTATED BYLAWS

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2000), the California Independent System Operator Corporation ("CAISO") hereby submits this Answer to the Protests and Comments filed in the captioned dockets on May 25, 2001 by the Reliant Energy Companies ("Reliant"), the Western Power Trading Forum ("WPTF"), Williams Energy Marketing & Trading ("Williams"), the Mirant Companies ("Mirant"), the Electric Power Supply Association ("EPSA"), and other parties (collectively, "Intervenors"),¹ in which Intervenors request

¹ The following parties filed either protests or comments: Dynegy Power Marketing; California Electricity Oversight Board; Mirant Americas Energy Marketing, LP, Mirant California, LLC, Mirant Delta, LLC, and Mirant Poterero, LLC; Reliant Energy Power Generation, Inc., and Reliant Energy Services, Inc.; NRG Power Marketing; Western Power Trading Forum; Pacific Gas and Electric Company; Enron Power Marketing, Inc.; Electric Power Supply Association; and Williams Energy Marketing and Trading.

Some of the Intervenors commenting substantively on the Amended and Restated Bylaws do so in portions of their pleadings variously styled as "Comments" or "Protest," without differentiation. There is no prohibition on the ISO's responding to the comments in these pleadings. The ISO is entitled to

that the Commission reject the Amended and Restated Bylaws filed by the CAISO on April 26, 2001.

I. Background

The history of the captioned proceedings has largely been one of the Commission and the parties trying to deal with a "moving target," i.e., the rapidly developing crisis in California's electricity market and the fast-moving events arising from it. For example, in its November 1 Order,² the Commission proposed a plan for responding to the California crisis; it then significantly modified its plan in the December 15 Order,³ significantly changed it in the March 9 Order⁴ and again in the April 26 Order,⁵ as further clarified in the May 25 Order.⁶

One of the aspects of this evolving Commission response to rapidly developing conditions has been its position with regard to the CAISO Governing Board. Yet, while

respond to these pleadings and requests notwithstanding the label applied to them. *Florida Power & Light Company*, 67 FERC ¶ 61,315 (1994). In the event that any portion of this answer is deemed an answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. §385.213) to permit it to make this answer. Good cause for this waiver exists here given the nature of this proceeding and the usefulness of this answer in ensuring the development of a complete record. See, e.g., *Enron Corporation*, 78 FERC ¶ 61,179 at 61,733, 61,741 (1997); *El Paso Electric Company*, 68 FERC ¶ 61,181 at 61,899 and n. 57 (1994).

² *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 93 FERC ¶ 61,121 (2000) ("November 1 Order").

³ *San Diego Gas & Electric Co. v. Sellers of Energy, et al.*, 93 FERC ¶ 61,294 (2000) ("December 15 Order").

⁴ *San Diego Gas & Electric Co. v. Sellers of Energy, et al.*, 94 FERC ¶ 61,245 (2001) ("March 9 Order").

⁵ *San Diego Gas & Electric Co. v. Sellers of Energy, et al.*, 95 FERC ¶ 61,115 (2001) ("April 26 Order").

⁶ *San Diego Gas & Electric Co. v. Sellers of Energy, et al.*, 95 FERC ¶ 61,275 (2001) ("May 25 Order").

some requirements have changed, the important constant in the Commission's thinking since its November 1 Order has been its insistence that the Governing Board be (1) a non-stakeholder body that (2) is independent of any Market Participants.

The CAISO submits that these two requirements are satisfied by the current Governing Board. In this context, California Assembly Bill 5X, which established the process through which the current members of the ISO Governing Board were selected, was responsive to the December 15 Order: it established a non-stakeholder Board, no member of which may be "affiliated with any actual or potential participant in any market administered by the Independent System Operator."⁷ This is precisely the end result contemplated by the Commission, as we shall demonstrate further below.

Some of the Intervenors have encouraged the Commission to see this proceeding as a test of regulatory strength, a turf war between the Commission and the California authorities, declaring that California has "defied" the Commission, and that the Commission must now demonstrate its dominance through a "tough response." See e.g. Mirant at 7; Williams at 6. The Commission should not heed this heated rhetoric. At bottom, this proceeding embodies an effort by both State and Federal regulators to achieve a single goal: a quick, effective, and fair solution to the critical problems arising from California's electricity crisis. Disagreements on how best to do this, and on who should or can do what, must be addressed promptly, dispassionately, and with an eye to maximum effectiveness in achieving the end goal. Appeals to regulatory *machismo* can have no role in this process if a resolution is to be found quickly.

⁷ CA Pub. Util. Code § 337(b) (as amended by A.B. No. 5, Jan. 18, 2001).

In this context, Intervenor's filings should be seen for what they are: the most recent salvos in a continuing campaign to maximize their profits at the expense of California ratepayers, which they have carried on since the inception of the CAISO.⁸ While their tone has become more shrill since they lost their ability to elect some of the members of the CAISO Governing Board, Intervenor's here are following a familiar pattern of vociferously attacking any CAISO action that they believe might cut into such profits – in this case, enormous windfall profits resulting from the exercise of market power.

While this is perhaps to be expected, much more is riding on the Commission's decisions in this case than the proper allocation of profits among a few Market Participants. The failure of electricity market restructuring in California – the first and most ambitious State to embrace the Commission's new market model – would be a major blow to the restructuring process around the country.⁹ Yet continued public support for any sort of restructuring in California – severely damaged by the events of the past two years – is crucially dependent upon the perception by state residents that their interests are being directly and seriously addressed as part of the restructuring process. Indeed, absent the vigorous steps taken by California officials in the past months – which Intervenor's bitterly attack as "defiance" of the Commission's authority –

⁸ While not arguing that such self-interest is illegitimate, the CAISO cannot resist pointing out the irony of the Intervenor's complaining that the State of California is self-interested.

⁹ Some states have already repealed their restructuring statutes or are in the process of considering such repeal. As explained by Ms. Marylyn Showalter, Chairwoman of the Washington Utilities and Transportation Commission, "lack of active supervision of prices in the west coast market is rapidly eroding political confidence that a competitive market is even the right policy objective." Transcript of the April 10, 2001 conference in Boise, Idaho at 33. Recently, the State of Nevada enacted AB 369 repealing most of its restructuring law. The measure prevents utilities from selling off their generating plants and stops implementation of retail access. In addition, the state of Rhode Island's legislature is considering repeal of its restructuring statutes.

it is likely that there might now be no independent system operator in California; overwhelming public outrage might have forced a complete return to the old regulatory regime of heavily-regulated, vertically-integrated monopoly electric utilities. In its deliberations on the issues raised here, the Commission should take seriously the political and popular pressure within California, and should be hesitant to remove what the California public perceives as a crucial part of its protection against some of the negative aspects of restructuring: a State government role in CAISO governance.

Indeed, as we shall show below: (1) the CAISO's current governance regime is consistent with the Commission's independence requirements; (2) Order No. 2000 provides that "special circumstances" – which is surely an understatement when applied to the current situation in California – warrant giving state government representatives a role in governance; (3) the CAISO is *not* favoring California over Intervenor or other Market Participants; and (4) the "cure" requested by Intervenor herein would be worse than the "disease" they purport to address.¹⁰

¹⁰ Intervenor also seek to interpose two procedural objections. Some Intervenor argue that the Commission should reject the CAISO's Bylaws filing outright, without evaluating their substance. See WPTF at 3; Mirant at 9-10. In support of this argument, these Intervenor cite a decision in which the Commission rejected a filing made under protest by a utility company pursuant to a specific order by its state regulatory agency. See *Western Massachusetts Electric Co.*, 23 FERC ¶ 61,025 (1983), *reh'g denied*, 23 FERC ¶ 61,345 (1983). Clearly, this case is inapposite here. The CAISO did not make its Bylaws filing under protest, nor did it do so pursuant to a state directive. Rather, the CAISO made the Bylaws filing in good faith to request Commission approval of changes necessary to implement its changed governance structure under state enabling legislation. Consequently, Intervenor's "legal nullity" argument has no bearing on the current matter.

Other Intervenor make much of dicta in the *WPTF v. FERC* case stating that "there may be remedies in the courts or before the Commission" if the CAISO acts in a discriminatory or unfair way. *Western Power Trading Forum v. FERC*, 245 F.3d 798, 803 (2001). However, this case does nothing to advance Intervenor's arguments, and does much to undercut them. In it, the Court recognized that "[t]he California electricity market is in flux," and that both the Commission and the State of California had advanced similar plans for a non-stakeholder Board, mooting several of WPTF's claims; the Court indicated that both these plans would serve the same objective of removing the non-independent stakeholder Board from control of the CAISO. *Id.* at 801-03. The Court also held that WPTF had no standing to advance its claims of bias by the CAISO Governing Board resulting from undue influence by

II. The Current CAISO Governing Board Satisfies the Commission's Independence Requirement

A. Consistency with the Commission's December 15 Order

The Intervenor makes a centerpiece of their pleadings the argument that the current CAISO Governing Board structure constitutes an egregious violation of the Commission's December 15 Order. EPSC at 4-5; WPTF at 4-8; Mirant at 6; Williams at 3-4, 7; Reliant at 4-5. For example, we are told that "the State of California ... chose to defiantly usurp the Commission's authority, violate the express directives of the December 15 Order, and unilaterally seat a Board of its own choosing." Williams at 4. However, a dispassionate reading of the December 15 Order in the context of concurrent and subsequent events, belies this overblown rhetoric.

In the first place, the seating of the new CAISO Board substantially complied with the December 15 Order, even as interpreted by Intervenor. The December 15 Order's core requirements are that "the ISO Governing Board be replaced with a non-stakeholder Board, and that the members selected to serve on the new Board be independent of market participants." All the other requirements in the Order are merely instrumental in accomplishing these core goals.¹¹ These core goals are both satisfied by the current Board, as demonstrated in the next subsection.

the State of California because WPTF's injury was "highly speculative." *Id.* at 802. WPTF is likewise unable today to show any evidence of real or imminent injury, as is clear from its Protest herein.

¹¹ December 15 Order at 62,013. These "instrumental" directives include instructions that the stakeholder Board relinquish its authority, that the CAISO continue to search for new Board members, and that further discussions with State representatives take place. The stakeholder Board did relinquish its authority, and the other two requirements were pursued until the seating of the new Board. However, even if there were technical deviations from these peripheral requirements of the Order, the seating of the new Board substantially complied with the December 15 Order.

Second, the Court of Appeals for the District of Columbia, which made itself intimately familiar with the November 1 and December 15 Orders for purposes of the *WPTF* case, clearly did not regard the seating of the new Board of Governors as necessarily inconsistent with the December 15 Order, but rather found that California's Assembly Bill No. 5X had "amplified" the effect of the Order.¹² Indeed, the Court's findings are directly contrary to intervenors' allegations that the seating of the new Board clearly violated the procedures prescribed in the December 15 Order. While the Court found that the December 15 Order had abolished the old stakeholder Board, it noted that the Order "leaves to the Commission's own future rulings any decision of how the new-style board will be selected."¹³ Given that the Court of Appeals' objective review of the December 15 Order concluded that the Commission had given no clear indication yet of how the new Board was to be seated, and that the State's actions were consistent with the Order, intervenors' demands that the State of California be penalized for violating the Order's procedures must be rejected.

Finally, as the Court of Appeals also pointed out, the "fast-moving life of California's energy problems" has operated to moot actions taken on the basis of events even a few weeks old, and has caused plans and proposals to be overtaken by events almost as soon as they are formulated.¹⁴ The Commission's April 26 Order was clearly intended to supersede its December 15 Order,¹⁵ and the Commission stated therein that

¹² *Western Power Trading Forum*, 245 F. 3d . at 802.

¹³ *Id.* at 801.

¹⁴ *Id.* at 799.

¹⁵ April 26 Order at 61,351.

it would issue new decisions on the CAISO governance issues in the future.¹⁶ Thus, any lack of conformance that may have existed between the seating of the new Board of Governors and the December 15 Order has now been mooted.

Given the language of the December 15 Order, its reasonable interpretation in the light of the fast-moving events of California's electricity crisis, and its supersession by the April 26 Order, the seating of the new CAISO Board does not violate the December 15 Order.

B. Consistency with the Independence Requirements of Order Nos. 888 and 2000

The Intervenor makes another centerpiece of their arguments the proposition that the new CAISO Board violates the Commission's Independence requirements. Intervenor alleges that the CAISO Board, and by extension the CAISO, are under the direct control of the State of California. WPTF at 7; Mirant at 15. They also allege that California has commercial and economic interests in the electricity market (Reliant at 5), and is now the "dominant" Market Participant in the electricity market. EPSA at 8; WPTF at 10; Reliant at 10.¹⁷ Intervenor purport to reason from these propositions that because a State agency is, in their view, a Market Participant, the State's alleged control over the CAISO Board violates the independence requirement, which provides that ISO governance must be independent of any Market Participant. Finally, Intervenor argues that such lack of independence will prevent the CAISO from

¹⁶ *Id.* at 61,353, n.9, 61,355, n.17.

¹⁷ They also argue that the new Board violates Section 205 of the Federal Power Act and the Commission's October 1997 Order (*Pacific Gas & Electric Co. et al.*, 81 FERC ¶ 61,122 (1997)) conditionally approving the CAISO. Reliant at 6. However, since the Independence standards discussed above represent the Commission's implementation of Section 205 and the October 1997 Order, these arguments will not be discussed separately.

integrating its market with the rest of the West, as the Commission has encouraged in Order No. 2000. EPSA at 7; WPTF at 12; Mirant at 17. Even assuming, for the sake of argument, that the "independence" requirement of Order No. 2000 establishes a relevant benchmark outside of the context in which it was promulgated – a requirement that must be met by regional transmission organizations ("RTOs") – these complaints are baseless.¹⁸ The CAISO demonstrates below that (1) the State of California does not control the CAISO; (2) the State of California is not a Market Participant; (3) it is not "lack of independence" that is preventing closer integration of CAISO's markets with the rest of the West; and (4) even if the State of California were a Market Participant, the emergency nature of the California electricity crisis would permit relaxation of the independence requirement.

1. The State of California Does Not Control the CAISO

Intervenors allege that "[i]n contravention of the requirements imposed by the December 15 Order, AB 5X directed the replacement of the existing ISO Governing Board with a five-member board to be appointed by the Governor and subject to confirmation and oversight by the EOB." Williams at 4. Intervenors argue that "[a]s a result, the ISO Board today is thus effectively functioning [as] an executive agency in the California state government." WPTF at 7.

Intervenors' argument is lacking in merit in many ways. First, it completely misrepresents the effect of the California statute that provided for the appointment of the

¹⁸ By arguing that it meets both standards of independence, the CAISO does not intend to waive its argument that the relevant standard here is supplied by Order No. 888, which governs ISOs, rather than Order No. 2000, which governs RTOs.

current Board. Indeed, rather than providing for a California "takeover" of the Board of Governors, A.B. 5X requires that the Board be an independent body.¹⁹

Second, the independent, non-discriminatory operation of the grid by the CAISO is assured through its Bylaws and Tariff.²⁰ The first stated purpose in the CAISO Bylaws is "to provide open and comparable access to similarly situated customers to the transmission facilities of those transmission owners that have transferred operational control of those facilities" to the CAISO.²¹ CAISO employees are required to adhere to this purpose and to offer open-access transmission service on a non-discriminatory basis.²² The CAISO Tariff in turn reflects these open-access and non-discrimination standards, explicitly stating that the CAISO shall provide "open and non-discriminatory access to the ISO Controlled Grid."²³ Clearly, acceding to "control" by California or any other person or entity for purposes of benefiting some users and disadvantaging others, as alleged by Intervenor, is completely inconsistent with the provisions of the CAISO's Bylaws and Tariff. Yet Intervenor has not pointed to a single instance where the CAISO has violated its Tariff or Bylaws, nor could they do so.²⁴

Third, protections are in place to ensure the CAISO Board of Governors' independence from outside influences. Both as a matter of state law and pursuant to the Bylaws, each Governor has a fiduciary obligation to perform his or her duties in

¹⁹ CA Pub. Util. Code § 337(b) (as amended by 2001 Cal. Stat. A.B. No. 5).

²⁰ Note that the Commission requires independence not for its own sake, but "to ensure fair and non-discriminatory access . . . for all users." Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,730-31.

²¹ Bylaws, Article II, Section 1(a).

²² See Employees Code of Conduct, Sections (a)(6)-(10).

²³ CAISO Tariff, § 2.1.1.

good faith in a manner that represents solely the interests of the CAISO.²⁵ In addition, the Governing Board operates under an Open Meeting Policy,²⁶ and makes all its documents (subject to limited specific exemptions) available to the public. Thus, in order to argue that the CAISO's Board is subject to "control" by California, Intervenor would have to argue, among other things, that the Governors are knowingly violating both state law and the CAISO's Bylaws. Again, Intervenor has not alleged such violations, nor could they.

Intervenor has completely failed to either allege or demonstrate a breakdown in the CAISO's protections against violations of the independence required by California statutes and the CAISO's own Bylaws and policies. They have likewise failed to either allege or demonstrate any violations by the CAISO of the provisions of its Tariff preserving its independence. Instead, Intervenor's arguments are based on innuendo, references to the fact that the CAISO's Governors are "trusted" by California state officials or have held responsible offices in state government, and political hyperbole excerpted out of context from press releases. Further, acceptance of Intervenor's arguments would require the Commission to find that the CAISO's Governors were knowingly violating state law. Unsupported speculation and innuendo are insufficient bases for findings as serious as these, and must be rejected.

²⁴ We refute Intervenor's factual allegations in the next section of this Answer.

²⁵ See California Corporations Code, Section 5231(a) (all directors of a non-profit, public benefit corporation to perform their duties, in good faith, in a manner they believe to be in the best interests of the corporation). See also CAISO Bylaws, Article III, Section 14.1 (same).

²⁶ Letter, Terry M. Winter, CAISO CEO, to Honorable Gray Davis, Governor of California, Aug. 8, 2000. Any interested party can also hear Board of Governors' open meetings live by dialing the CAISO's conference line announced in the agenda for each meeting or, beginning in November 2000, through the internet.

2. The State of California Is Not a Market Participant

As we have shown above, the State of California does not exercise "control" of the CAISO. However, even if California did exercise control, this would not be inconsistent with the Commission's Independence requirement. This is because the Commission only requires ISO governance to be independent from *Market Participants*, as it has defined the term.²⁷ The California statute providing for the seating of the new Board of Governors has ensured such independence by requiring that no member of the Board may "be affiliated with any actual or potential participant in any market administered by the Independent System Operator."²⁸ The State of California itself is not a Market Participant under the Commission's definition, for the simple reason that it has no commercial or economic interests in the electricity market; rather, like the CAISO itself, its activities in the market are undertaken purely in the public interest, and on behalf of others, without a profit motive. In this context, the current case is like *New England Power Pool*,²⁹ in which certain market entities argued that ISO-New England should be required to separate its transmission and market functions, as required of all Market Participants. The Commission rejected this argument, finding that:

Stakeholders' concern that the ISO will be a participant in the economy energy market is unfounded. First, we note that NEPOOL has stated that the ISO will not be a participant in the economy energy market Thus, the ISO will have no incentive to favor any one class of transactions or to discriminate against bilateral transactions. Rather, the ISO, *to the extent necessary, will buy or sell emergency power to ensure short-term*

²⁷ See e.g. Order No. 888, FERC Stats. & Regs. ¶ 31,036 at 31,730-31; *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 at 31,061-31,062 (Dec. 20, 1999), 65 Fed. Reg. 809 (Jan. 6, 2000), ("Order No. 2000"); *on reh'g*, Order No. 2000-A, FERC Stats. & Regs. ¶ 31,092 (Feb. 25, 2000), 65 Fed. Reg. 12,088 (Mar. 8, 2000)

²⁸ CA Pub. Util. Code § 337(b) (as amended by 2001 Cal. Stat. A.B. No. 5X).

²⁹ 85 FERC ¶ 61,242 (1996).

reliability of the grid. . . . (footnote omitted) Therefore, contrary to Stakeholders' claim, there should be no real or perceived appearance of partiality by the ISO toward certain types of transactions as a result of this market structure.³⁰ (emphasis added).

Note that "buying . . . emergency power to ensure short-term reliability of the grid" is precisely the activity of the California Energy Resources Scheduler (CERS) of the State's Department of Water Resources ("DWR") that Intervenors have identified as the basis for California being considered a Market Participant. See e.g. EPSA at 8-9; WPTF at 9-10. However, the Commission has clearly distinguished this activity from the activities that bring an entity within the definition of a Market Participant.³¹

In addition to the above, Order No. 2000 creates a presumption that an entity that merely makes *purchases* from an RTO's markets is not a Market Participant.³² Separate and apart from emergency CERS activities, DWR does bid some limited Generation and Load into the CAISO's markets from the State Water Project ("SWP"). The amount so bid for the SWP is vanishingly small compared to the purchases that its CERS arm makes in support of market reliability, and furthermore, is bid under a Scheduling Coordinator identification code separate from the codes used by DWR to make emergency purchases to meet the net-short position of the utilities.³³ Consequently, even if DWR, and by extension the State of California, could be considered to have

³⁰ 85 FERC ¶ 61,242 at 62,011.

³¹ Order No. 2000 has further found that Market Participant status will not arise from such activity even if it is performed by an entity other than the RTO. As long as this other entity is performing this action on behalf of the RTO's customers, this entity will not be considered a Market Participant. *Regional Transmission Organizations (NOPR)*, FERC Stats. & Regs., 32,541 at 33,746, (1999). The Commission subsequently adopted this rule at Order No. 2000 at 31,141, 18 C.F.R. § 35.34(k)(4)(iii). Again, this is exactly the role the State of California performs in the current situation.

³² Order No. 2000 at 31,061 (2000).

³³ Additionally, CERS and the CAISO have taken appropriate measures to ensure that this material remains confidential; no intervenor has offered any evidence of any information being used improperly.

some economic or commercial interests in the markets because of these Energy sales, the lack of significance of these sales would prevent California from being considered a Market Participant.³⁴

3. Lack of Independence Is Not Preventing Integration of California With Other Markets in the West

Several intervenors allege that the CAISO Board's purported lack of independence makes it impossible for California to integrate its markets with others in the West. EPSC at 7; WPTF at 11-12; Mirant at 17. We are told that "development of a regional RTO . . . requires that [the CAISO's grid] be operated in a manner that serves regional interests fairly and in a nondiscriminatory fashion, not solely the interests of DWR No neighboring state will ever join with the ISO in an RTO as long as it remains such a highly politicized body controlled in Sacramento." WPTF at 11-12. This position is completely meritless. It is clearly *not* California's governance structure that makes other states reluctant to integrate their markets with California's: this reluctance existed long before the change in membership of the ISO's Governing Board. It is California's unstable markets and extremely high electricity prices that have repelled prospective partners in the fear that these conditions could spill over into their own jurisdictions if such an integration took place. Yet these are the very instabilities and high prices that the California authorities are working desperately to correct, including petitioning the Commission for effective price mitigation authority.³⁵

³⁴ *Id.* One intervenor also alleges that individual CAISO Governors have "close business or other financial connections" with entities that it claims are Market Participants. See Reliant at 5, n.3. However, beyond this bare statement, Reliant offers no evidence for this claim, which the CAISO states on information and belief is untrue.

³⁵ Indeed, the Secretary of Energy noted this very concern in his April 23, 2001 letter to the Commission in Docket No. RT01-35-000 concerning RTO West.

4. The Crisis in California Requires Relaxation of the Independence Requirement

Finally, even if the Commission were to conclude that CERS' activities make the State a Market Participant and the State does "control" the CAISO, the crisis in California rises to a level at which relaxation of the Independence requirement is both appropriate and necessary. In Order No. 2000, the Commission held that there may be "special circumstances" in which it would even be appropriate to give state government representatives seats on an RTO governing board.³⁶ (Note that none of the current CAISO Governors is serving as such a representative.) It is difficult to conceive of "special circumstances" more exigent than those now existing in California, where catastrophic price increases have drained billions of dollars out of the state, rolling blackouts have afflicted communities and industry, and where some residents have faced serious financial distress as a result of exorbitant utility bills. Such a relaxation of the Independence mechanism would also be consistent with the Commission's policies with respect to another requirement that supports nondiscriminatory access, the Code of Conduct provisions of Order No. 889. There, the Commission permits system operators to "take whatever steps are necessary to maintain system reliability during an

I am aware that some believe a single RTO in the Western United States is a better solution than the regional approach proposed. The Department supports the development of seamless electricity markets. However, we believe the best way to achieve this goal is to take thoughtful first steps that the region can support...As a practical matter, this approach may be necessary in the Northwest to maintain support for an RTO, given the fears that California's problems will be imported to a West-wide RTO.

³⁶ See Order No. 2000 at 31,075.

emergency, notwithstanding that this could otherwise constitute a violation of the standards of conduct.³⁷

C. The CAISO Does Not Favor California Interests Over Those of Market Participants

In support of their arguments that the State of California "controls" the CAISO, some Intervenors have adduced alleged instances where the CAISO has discriminated against Market Participants and in favor of California. The flimsy and wholly meritless character of their "examples" speaks volumes about the validity of Intervenors' arguments, however. We address each of these "examples" below.

1. Creditworthiness of Counter-Parties

Certain Intervenors allege that CAISO dispatches Generation in the absence of creditworthy counter-parties in order to advance the interests of California, without taking account of the detrimental effect of this practice on Generators. See WPTF at 13; Reliant at 2. One Intervenor even accuses the CAISO of using its emergency dispatch authority in the absence of creditworthy counter-parties to force Market Participants into long-term supply contracts with the State. EPSA at 10. These allegations are wholly false. In fact, the ISO has implemented procedures and filed conforming Tariff language required by the Commission's recent Order on this subject, protecting Market Participants from non-creditworthy counter-parties.³⁸

On April 13, 2001, the ISO issued a notice to all Market Participants describing the terms under which CERS has agreed to "assume financial responsibility for all

³⁷ *Open Access Same-Time Information System and Standards of Conduct*, FERC Stats. & Regs. ¶ 31,035, 31,601 (1996).

³⁸ See *California Independent System Operator Corp., et al.*, 95 FERC ¶ 61,024 (2001).

purchases by the ISO in its ancillary services and Imbalance Energy markets based on bids or other offers determined to be reasonable.³⁹

On May 11, 2001, the ISO submitted its Compliance filing in Docket No. ER01-889-003. Those Tariff revisions, submitted to comply with a letter order issued by the Commission on April 26, 2001, provide that "the ISO will only instruct the dispatch of Imbalance Energy to the extent that the purchase of such Imbalance Energy is on behalf of a Scheduling Coordinator that complies with the creditworthiness requirements of [the ISO Tariff] or to the extent an entity . . . has provided assurance of payment on behalf of the Scheduling Coordinator." On May 25 2001, the ISO issued a supplemental Market Notice on credit issues. The ISO stated:

Pending rehearing, unless the ISO can provide reasonable assurances that a party meeting the ISO's credit requirements will support a specific transaction, the ISO will not enter into the transaction with respect to any resource. This includes (1) awarding capacity bids in the forward Ancillary Service ("AS") markets and (2) dispatching Imbalance Energy bids in the real time market. Therefore, the ISO will not award AS capacity bids nor will it dispatch Imbalance Energy bids above the prices for which CDWR will agree to provide credit backing. Imbalance Energy bids above the prices for which CDWR has agreed to provide credit backing, though not accepted, shall remain in the "BEEP" stack. Accordingly, in accordance with ISO Tariff §§5.1.3 and 11.2.4, resources will not be subject to Out-Of-Market calls unless the ISO has secured a creditworthy buyer for these unawarded Supplemental Energy Bids. See, e.g., ISO Tariff §§ 5.6.2 and 5.1.3. A separate notice will be issued regarding Reliability Must Run.

A fuller discussion is contained in the CAISO's recent filing on this issue.⁴⁰

³⁹ See Request for Rehearing Motion for Expedited Consideration and Motion for Clarification of the California ISO, in Dockets ER01-889-004, et al. filed May 7th, 2001 at Attachment A.

⁴⁰ See Answer of the California Independent System Operator Corporation In Opposition to the Expedited Motion for Enforcement Action, filed June 6, 2001 in Docket Nos. ER01-889-003 and EL00-95-012 et al.

2. Allowing CERS Access to the CAISO's Control Room

Some Intervenor has accused the CAISO of favoring California over Market Participants by permitting representatives of CERS access to CAISO's control room, access denied to Market Participants. As demonstrated above, CERS is not a Market Participant, and so is not excluded under the CAISO's rules. In addition, however, CERS, the only party that has stepped forward to provide the credit support necessary to meet the emergency needs of California consumers pursuant to the Commission's Order of April 6, 2001,⁴¹ has advised the CAISO that it must have access to the CAISO control room and to a limited amount of nonpublic information in order to discharge this responsibility and has in fact conditioned its willingness to provide such credit support on the CAISO's willingness to abide by these measures. Absent CERS' willingness to undertake this credit support, the CAISO would have absolutely no way to discharge its most fundamental reliability responsibilities. For this reason, and in light of the fact that CERS is not a Market Participant, the CAISO has permitted CERS access to its control room for this limited purpose. Further discussion can be found in a recent CAISO filing on this subject.⁴²

3. ATC on the California-Oregon Intertie

One Intervenor has accused the CAISO of listing on its OASIS artificially reduced Available Transmission Capacity ("ATC") figures on the California-Oregon Intertie ("COI") in order to discourage export of electricity from California. This accusation is

⁴¹ 95 FERC ¶ 61,024 (2001).

⁴² See CAISO's May 11, 2001 Compliance Filing in Docket No. ER01-889-005.

wholly false. In fact, the ISO reduces the COI ATC to prevent overloading on Path 15⁴³ which, with the COI, is a series segment in the 500-kV backbone transmission system connecting Arizona, California, Oregon and Washington.⁴⁴ If the ISO did not reduce COI ATC before real-time, it would almost certainly have to substantially cut inter-regional transfers of electricity through California in real-time to ensure the reliability of Path 15 and, potentially, the entire Western interconnection. The COI, not Path 15, is the Scheduling Point for inter-regional transactions. Earlier attempts by the ISO to reduce the ATC on Path 15 proved ineffective, leading to disruptive and burdensome real-time cuts that, if not made, had the potential to create interconnection-wide reliability concerns. By limiting the ATC on COI before real-time (which it does through a special automated tool designed to make such reductions as surgically precise as possible under dynamic system conditions), the ISO tries to reduce the overall impact on Market Participants by allowing them to make other arrangements for their transactions in advance which might not be available when cuts are made in real-time to ensure system reliability. While intervenors who mistakenly assert a California-first intent to this practice may chafe at its effects, they would almost certainly find the effects of not engaging in this prudent practice – massive real-time cuts – to be even more odious. This practice, which has to do with power flow, not state politics, is

⁴³ Path 15 is composed of the Los Banos-Gates 500-kV line, the Los Banos-Midway 500-kV line, and the Gates-Panoche #1 and #2 230 kV lines, the Gates-Gregg 230-kV line and the Gates-McCall 230-kV line.

⁴⁴ South-to-north overloads on Path 15, which typically occur during the winter due to reduced Pacific Northwest hydroelectric Generation and higher Pacific Northwest heating Load requirements, were exacerbated in 2001 by extraordinarily low rainfall in the Pacific Northwest that reduced hydroelectric Generation even more.

intended to reduce the effects on Scheduling Coordinators, not to wall off California from the rest of the west.

4. CAISO Maintenance Outage Policies

One Intervenor has accused the CAISO of adjusting its maintenance outage schedules to serve California's short-term Energy needs at the expense of long-term reliability. Reliant at 9. This is not the case, however. In fact, the changes that Intervenor has noticed in the CAISO's Outage are consistent with the requirements of the Commission's April 26 Order, which directs the CAISO, among other things, to schedule and cancel outages in order to avert undue market impacts.⁴⁵ These changes in practice, while they may sometimes seem onerous to Generators, are necessary to address California's ongoing electricity crisis.

III. The Commission Should Deny the Intervenor's Requested Relief

While we have demonstrated above that the Intervenor's attacks on the CAISO's Amended and Restated Bylaws are meritless, the CAISO also respectfully suggests that granting the Intervenor the relief they seek might have exactly the opposite effect from that intended by the Commission. As discussed in the first section of this Answer, the CAISO believes that the State of California enacted 5X, the statute providing for the seating of the new CAISO Board, in response to the enormous public outrage occasioned by the insupportably high and unstable electricity prices experienced in the State over the past months, as well as the Commission's perceived refusal to control such prices by means of effective price mitigation authority. Consequently, the CAISO believes that it is not outside the bounds of possibility that a rejection by the

⁴⁵ April 26 Order at 61,354-355.

Commission of the CAISO's Amended and Restated Bylaws could result in a decision by political authorities in California to disband the CAISO entirely, and perhaps even to revert to the pre-restructuring electricity market model.⁴⁶ Such a result would obviously be a major setback for electricity market restructuring in the United States, and would run directly counter to the Commission's goals.

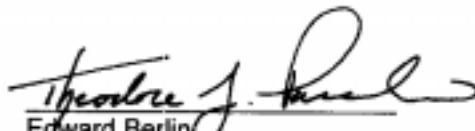
IV. CONCLUSION

For the foregoing reasons, the CAISO requests that the Commission deny the Protests and Comments of the Intervenors and accept the CAISO's Amended and Restated Bylaws as filed.

Respectfully submitted,



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⁴⁶ A state's ability to effect such changes contrary to the Commission's wishes is apparently an issue of first impression. However, given that the CAISO is a California corporation created by a California State statute and operating only within the State of California, the likelihood of such an outcome does not seem remote.

