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June 7, 2004

## Via Electronic Filing

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

**Re: Pacific Gas and Electric Company v. California Independent  
System Operator Corporation, Docket No. EL04-103-000**

Dear Secretary Salas:

Enclosed please find the Answer of the California Independent System Operator Corporation to the Complaint of Pacific Gas and Electric Company, submitted today in the above-captioned proceeding.

Thank you for your attention to this matter.

Respectfully submitted,

/s/ Bradley R. Miliauskas  
Bradley R. Miliauskas

Counsel for the California Independent  
System Operator Corporation

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

<b>Pacific Gas and Electric Company</b>	)	
	)	
<b>Complainant,</b>	)	
	)	
v.	)	<b>Docket No. EL04-103-000</b>
	)	
<b>California Independent System Operator Corporation</b>	)	
	)	
<b>Respondent.</b>	)	

**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR  
CORPORATION TO THE COMPLAINT OF  
PACIFIC GAS AND ELECTRIC COMPANY**

Pursuant to Rule 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. § 385.213, and the Notice of Filing issued in the above-captioned proceeding on May 19, 2004, the California Independent System Operator Corporation ("ISO")<sup>1</sup> hereby submits its answer to the complaint submitted by Pacific Gas and Electric Company ("Complaint," submitted by "PG&E") on May 18, 2004.

**I. BACKGROUND**

On December 19, 2001, the Commission issued two orders related to the must-offer obligation. The first order, *San Diego Gas & Electric Company*, 97 FERC ¶ 61,275, was issued on rehearing of the April 26, 2001 order in the same proceeding.<sup>2</sup> The second order, *San Diego Gas & Electric Company*,

<sup>1</sup> Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff.

<sup>2</sup> *San Diego Gas & Electric Company*, 95 FERC ¶ 61,115 (2001).

97 FERC ¶ 61,293 (“December 19 Compliance Order”) concerned the ISO’s July 10, 2001 filing to comply with the Commission’s June 19, 2001 order in the same proceeding.<sup>3</sup> The Commission found the ISO’s proposal to grant waivers of the must-offer obligation reasonable and directed the ISO to develop tariff provisions for granting exemptions of the must-offer obligation, effective July 20, 2001. In its June 19 Order, the Commission directed that Start-Up Fuel Costs be allocated to load on the ISO’s system.<sup>4</sup> In its December 19 Compliance Order, the Commission directed that minimum load costs be allocated in a manner consistent with how Start-Up Fuel and Emissions Costs are allocated.<sup>5</sup> In both cases, these costs are allocated to the same constituency – metered Demand within the ISO Control Area, plus exports to other Control Areas within California.

On May 11, 2004, the ISO filed Amendment No. 60 to the ISO Tariff in Docket No. ER04-835-000 (“Amendment No. 60”). Amendment No. 60 proposes to modify and improve the Tariff provisions related to the implementation of the Commission-imposed must-offer obligation, including allocation issues related to Minimum Load Cost Compensation (“MLCC”).

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<sup>3</sup> *San Diego Gas & Electric Company*, 95 FERC ¶ 61,417 (2001) (“June 19 Order”).

<sup>4</sup> *Id.* at 62,563.

<sup>5</sup> December 19 Compliance Order at 62,363.

## II. ANSWER

### A. **PG&E Provides No Support for its Allegation that the ISO Has Violated the Filed Rate Doctrine, Nor Has the ISO Violated the Filed Rate Doctrine**

PG&E states that it is filing its complaint against the ISO “for violations of the ‘filed rate doctrine’ under Section 205 of the [Federal Power Act] and certain rules, regulations, and orders promulgated thereunder.” Complaint at 1.

However, nowhere in the body of the complaint does PG&E support this allegation. Further, PG&E’s charge is wholly without merit. The ISO makes MLCC payments and allocates MLCC costs in accordance with its Commission-approved ISO Tariff provisions. Because the ISO makes those payments and allocates those costs in accordance with the approved Tariff provisions, the ISO has not violated the filed rate doctrine.

### B. **While the Amendment No. 60 Provides Ways to Allocate MLCC Costs that Better Reflect Cost Causation Principles, the Improved Allocation Methodology in Amendment No. 60 Does Not Render the Current Methodology Unjust and Unreasonable**

As PG&E notes, Amendment No. 60 addresses the precise issue raised in the complaint. Complaint at 1. That the ISO’s proposal will resolve PG&E’s concern is best illustrated by the fact that PG&E did not protest the ISO’s Amendment No. 60 filing and in fact supports the revised allocation of MLCC costs.<sup>6</sup>

The fact that the ISO has sought to improve its MLCC allocation methodology does not, however, render the current Commission-approved

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<sup>6</sup> See Motion to Intervene Out-of-Time and Comments of Pacific Gas and Electric Company, Docket No. ER04-835-000 (June 2, 2004), at 4 (“PG&E . . . supports the ISO proposal to establish appropriate reallocations of the MOO costs, based upon allocation regionally where the cost causation is local reliability.”)

process unjust and unreasonable. It is well settled that for a rate design proposal to be acceptable, it need be neither perfect nor even the most "desirable"; it need only be reasonable.<sup>7</sup> The ISO is currently allocating MLCC costs in accordance with the Commission's direction; the Commission has thus already found the current methodology (which the proposal in Amendment No. 60 improves upon) to be reasonable.

### C. PG&E's Requested Relief Is Infeasible

The ISO filed Amendment No. 60 on May 11, 2004, just one week before PG&E filed the instant complaint. The ISO agrees with PG&E that the MLCC cost allocation methodology should be consistent with cost-causation principles and that Amendment No. 60 will allocate MLCC with greater precision than the current methodology. The ISO also appreciates PG&E's concern that this methodology be approved and implemented expeditiously.

However, for the reasons discussed in the affidavit of Donald Fuller (provided as Attachment A to the present filing) it is not practicable for the ISO to implement the new allocation proposal in sixty days. First, the ISO must await Commission approval of its concept. Second, even assuming approval, as Mr. Fuller explains, the ISO must make significant modification to its data collection and settlement systems. Moreover, the ISO would be making these changes at

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<sup>7</sup> See *New England Power Co.*, 52 FERC ¶ 61,090, at 61,336 (1990), *reh'g denied*, 54 FERC ¶ 61,055, *aff'd sub nom. Town of Norwood v. FERC*, 962 F.2d 20 (D.C. Cir. 1992) (citing *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 917 (1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to alternatives); *OXY USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C. Cir. 1995) ("[T]he Commission may approve the methodology proposed in the settlement agreement if it is 'just and reasonable'; it need not be the only reasonable methodology or even the most accurate.").

the same time it is implementing the Commission-approved changes from Phase 1B of MDO2.

### III. CONCLUSION

For the reasons discussed above, the ISO respectfully requests that the Commission deny PG&E's complaint.

Respectfully submitted,

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Date: June 7, 2004

**ATTACHMENT A**

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

<b>Pacific Gas and Electric Company</b>	)	
	)	
<b>Complainant,</b>	)	
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v.	)	<b>Docket No. EL04-103-000</b>
	)	
<b>California Independent System Operator Corporation</b>	)	
	)	
<b>Respondent.</b>	)	

**AFFIDAVIT OF DONALD L. FULLER  
ON BEHALF OF THE CALIFORNIA INDEPENDENT  
SYSTEM OPERATOR CORPORATION  
CONCERNING THE IMPLEMENTATION OF A SYSTEM TO ALLOCATE MINIMUM  
LOAD COSTS AS PROPOSED IN AMENDMENT NO. 60**

1. My name is Donald L. Fuller. I am employed by the California Independent System Operator Corporation ("ISO") as the Director of Billing and Settlements. My business address is 151 Blue Ravine Road, Folsom, California 95630.
2. I oversee the operation of the ISO's financial settlement systems to ensure that sellers, buyers and other parties interacting with the ISO markets are paid and charged appropriately according to the settlement provisions of the ISO Tariff. In my current position I oversee a staff of 48 personnel, including full-time employees and contractors. My department is responsible for settling the wholesale electricity activities for all of the ISO's participants, and producing preliminary and final settlement statements and invoices, including RMR verification and invoicing activities. In addition, my staff is often called upon to



produce estimates of the impacts of potential tariff amendments and market redesign proposals as well as to develop the algorithms and processes required to implement changes to the ISO Tariff. Further, my staff is responsible for both the market rerun projects described in Amendment No. 51 to the ISO Tariff and the California refund proceeding stemming from the 2000-01 crises.

In my previous position with the ISO, I was Director of Client Relations for four years where my responsibilities included working directly with Scheduling Coordinators on dispute related matters that impacted the ISO's settlement and billing systems.

Prior to joining the ISO, I was employed for over 20 years at Westinghouse Electric Corporation in its power generation businesses. I held various management positions during this time, most recently as Manager of Subsidiary Operations where I had direct profit/loss responsibility. I hold a B.S. degree in Electrical Engineering from Oregon State University in Corvallis, Oregon and an MBA, with an emphasis in finance, from Widener University in Chester, Pennsylvania.

3. The purpose of my affidavit is to describe why the ISO requested in Amendment No. 60 to implement the modifications to the allocation of Minimum Load Costs consistent with the timing of the MD02 Phase 1B software modifications.
4. In accordance with the must-offer mitigation methodology imposed by the Commission to remedy physical withholding in the California market, one of the

payments the ISO must make to suppliers covers their Minimum Load Costs. Currently, responsibility for these payments is allocated to metered Demand within the ISO Control Area and exports from the ISO Control Area to Demand within California. This allocation methodology was approved by the Commission in an Order issued December 19, 2001.

5. The allocation for Minimum Load Costs is carried out through the following process. First, when the ISO denies or revokes a Must-Offer Waiver for a Generating Unit, ISO Grid Operators log that action in a software application known as the Must-Offer Obligation Tool, or MOO Tool. The MOO tool writes the data into the ISO's Scheduling Infrastructure (SI) Database. A post-process calculation script calculates the Minimum Load Costs for each hour of the Waiver Denial Periods established for the Must-Offer Generators that were denied a waiver from the must-offer obligation and logged via the MOO Tool. The post-process script also checks other tables in the SI Database to determine a first level of eligibility to receive Minimum Load Costs by detecting Final Hour-Ahead Energy Schedules, Final Hour-Ahead Ancillary Service Awards and Real Time Dispatch Instructions. This is necessary because the ISO must not compensate its Minimum Load Costs if the resource self-schedules.
6. On a monthly basis, the results of the post-process calculation script are transferred to the Settlements Database, where this transactional data regarding the eligible Minimum Load Costs are processed by the Settlements System for payment and allocation. First, the system compares, for each hour, the expected minimum load energy quantity with the hourly Metered quantity to verify that the

unit's output is within the required Tolerance Band.<sup>1</sup> This is necessary because the unit is ineligible to receive its Minimum Load Costs for each hour it did not meet the Tolerance Band. Next, the system calculates the monthly Minimum Load Cost Compensation (MLCC) for each unit by summing the Minimum Load Costs for each eligible hour. To determine the monthly MLCC allocated to each Scheduling Coordinator, the ISO multiplies a per unit price, by the sum of the Scheduling Coordinator's metered Load within the ISO Control Area plus its Real-time exports from the ISO Control Area to Demand within California. This per-unit price is calculated by dividing the total monthly Minimum Load Cost Compensation (for all units) by the total ISO Metered Load plus Real-time exports to California Control Areas.

7. In Amendment No. 60, the ISO proposed several significant revisions to the process for compensating generators for Minimum Load Costs and allocating responsibility for those costs to Loads. The changes needed to implement the Minimum Load Cost allocations proposed in Amendment No. 60 are as follows.
8. In Amendment No. 54, the Commission approved a new method of Minimum Load Cost Compensation as follows: (1) For each eligible Settlement Interval, the ISO accounts for the Minimum Load energy as Instructed Imbalance Energy and settles it at the Resource-Specific Ex Post Price for the Settlement Interval, and (2) to the extent the Instructed Imbalance Energy payment is insufficient recovery of the generating unit's Minimum Load Cost, the generator will also receive an uplift payment or Minimum Load Cost Compensation (MLCC). Thus, in the new

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<sup>1</sup> The Tolerance Band amount is the greater of 5 MW or three percent of the unit's maximum operating level.

Phase 1B methodology, the ISO will compute an uplift amount to guarantee Minimum Load Cost Compensation for each Settlement Interval.

9. With regard to allocation of costs, the ISO has proposed in Amendment No. 60 to assign these costs based on finer cost causation. To achieve this precision the ISO Must Offer Obligation Tool used in operations must be modified and dispatch staff trained on logging the Waiver Denial into one of three categories – system-wide need, local requirements, or zonal needs. Currently the reasons for waiver denials are captured via SLIC logs – a manual process not currently used for settlement purposes. As a result of Amendment No. 60, this process would need to capture the data regarding the purpose of the waiver denial in the MOO Tool automatically. Second, the ISO must modify the Settlements software code to be able to allocate to four specific categories of costs and Market Participants. The new allocation methodology must also be designed to work with the new Minimum Load Cost Compensation payment methodology approved by the Commission in Amendment No. 54, as described above. In the new methodology, the ISO will compute an uplift amount to guarantee MLCC for each Settlement Interval. Thus, the total Minimum Load Costs to be allocated monthly will only consist of the sum of all the Settlement Interval uplift amounts for each of the four specific categories paid to the generators for the month. The Settlements methodology must further incorporate business rules to “split up” these uplift costs between incremental costs for local reliability versus costs for system needs for each Settlement Interval (i.e., for every 10 minutes for every hour for every day), prior to determining the monthly costs for allocation.

10. The ISO estimates that implementation of this allocation methodology will take three and a half months for design, development and testing. The ISO also plans on providing to its Scheduling Coordinators the Settlement statement technical specifications two to three weeks in advance of Market Simulation, so that they have time to modify and test their Settlement Systems to process the four new allocation charge types. Finally, the implementation schedule must coincide with the implementation schedule for Amendment No. 54 to ensure that these changes are merged with the other Amendment No. 54 functions and sufficiently acceptance tested with Scheduling Coordinators prior to full implementation.

11. PG&E raises the possibility of allocating the costs manually prior to implementation of Amendment No. 60 on the Phase 1B schedule. In addition to the difficulties of implementing manual processes, the effort to develop the tools would likely operate for only 2-3 months, and would then be "thrown away" when the cost allocation software discussed above goes into effect with Phase 1B. The ISO strongly recommends against requiring such a manual process. A manual process would take time to develop, be labor intensive to implement, and lead to errors. Allocating costs through manual process rather than through thoroughly designed and tested software modifications inevitably leads to further staff-intensive manual work when Market Participants dispute inconsistent charges. Allocations of costs to specific billing determinants should be implemented through changes to software code rather than through manual processes to provide accuracy and repeatability. Setting up the necessary procedures and controls to ensure that manual calculations are accurate,

complete and consistent and are documented (e.g., to comply with SAS-70 type II standards for business processes) can take as much staff time and effort as properly implementing automated allocation through software changes.

12. The Settlements group is currently involved in several projects critically needed to address future ISO and Market Participant requirements. These include changes needed (1) to implement the 2004 Grid Management Charge; (2) to implement the Phase 1B modifications approved by the Commission in Amendment Nos. 44 and 54 (and already twice delayed); (3) to design and procure a new Settlements and Market Clearing (SaMC) system, which is urgently needed to replace the current inflexible manual-intensive system; and (4) to implement the modifications to the allocation of Minimum Load Costs proposed in Amendment No. 60 in time for the Phase 1B implementation. Each of these important changes relies on a limited number of staff. The ISO has reviewed options of bringing in additional staff, but the short time-frame combined with a limited staff to train new people doesn't help the bottleneck. Concentrating staff resources on any one project (e.g., on the Amendment No. 60 modifications) to advance the implementation of that one project will inevitably delay the implementation of the other projects. Moreover, other ISO settlements staff are also involved in important settlement projects, such as supporting and conducting the preparatory market re-run effort underway to support the California refund proceeding. Due to tight re-run timelines these staff cannot be shifted to help with these projects. Finally, in addition to these extraordinary

projects, the settlements group must continue to settle the ISO's market activity on a day-to-day basis.

13. All settlement system modifications are made through a rigorous Software Development Life Cycle (SDLC) process that includes the following steps prior to implementation: (1) defining business requirements and creating a detailed design; (2) implementing the requirements and design through changes to the settlements system code; (3) acceptance testing and end-user testing; (4) post-testing repairs and modifications; (5) market simulation and (6) cutover to operation. The ISO adheres to the SDLC process when modifying its software systems to provide the greatest possible likelihood that its software systems provide quality output. This, in turn, assures ISO Market Participants, all of whom have a significant financial stake in the output produced by the ISO's software systems, that the settlements statements produced are accurate and complete. The ISO currently estimates that the SDLC steps needed to implement the modifications to the allocations of Minimum Load Costs will take the following amounts of time: 4 weeks for design and requirements specification; 4 weeks for code development; 3 weeks for acceptance and end-user testing; 1 week for repairs and modifications; 2 weeks for the market simulation; and 2 to 3 weeks for cutover.

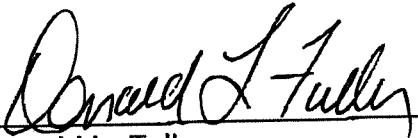
14. The ISO is currently making substantial changes to its settlements systems to implement the Phase 1B modifications, which the ISO currently expects to be ready in Fall 2004. The ISO has proposed to incorporate the modifications to the allocation of Minimum Load Costs proposed in Amendment No. 60 in the post-

Phase 1B settlements systems. The schedule of activities listed in the previous section requires advance work by the ISO prior to FERC approval of Amendment No. 60. To provide for those modifications in the settlements system prior to Phase 1B, the ISO will have to initiate manual processes and procedures that will only be in service for a few months, and then discarded with Phase 1B implementation. If the ISO must concentrate on an early implementation of the Amendment No. 60 Minimum Load Cost allocation, the Phase 1B modifications will inevitably be delayed.

15. In summary, I believe that implementing the modifications to the allocation of Minimum Load Costs proposed in Amendment No. 60 at the same time the Phase 1B modifications are implemented is the most prudent course of action. It will allow the ISO to automate the allocation of Minimum Load Costs so that the allocations are made consistently and accurately. It will eliminate increasing amounts of ongoing manual work that can lead to disputes. Finally, it will prevent the delay of other key projects that affect all Market Participants, including Phase 1B modifications, 2004 Grid Management Charge Settlement implementation, Refund rerun work, and replacement of the existing settlements system.



16. I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

  
Donald L. Fuller  
Director of Settlements

Executed on June 7, 2004.

## CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California, on this 7<sup>th</sup> day of June, 2004.

/s/ Anthony Ivancovich  
Anthony Ivancovich