

April 1, 2003

Attn: Commission's Docket Office
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

RE: Docket # I.00-11-001, Order Instituting Investigation Into Implementation of
Assembly Bill 970 Regarding the Identification of Electric Transmission and Distribution
Constraints, Actions to Resolve Those Constraints, and Related Matters Affecting the
Reliability of Electric Supply

Dear Clerk:

Enclosed for filing please find an original and eight copies of the Notice of Ex Parte Communication of the California Independent System Operator Corporation in Docket # I.00-11-001. Please date stamp one copy and return to California ISO in the self-addressed stamped envelope provided.

Thank you.

Sincerely,

Jeanne M. Solé
Regulatory Counsel

Cc: Attached Service List

**BEFORE THE PUBLIC UTILITIES COMMISSION OF
THE STATE OF CALIFORNIA**

Order Instituting Investigation into)
implementation of Assembly Bill 970 regarding)
the identification of electric transmission and)
distribution constraints, actions to resolve those)
constraints, and related matters affecting the)
reliability of electric supply.)

I.00-11-001

**NOTICE OF EX PARTE COMMUNICATION OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION**

April 1, 2003

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**BEFORE THE PUBLIC UTILITIES COMMISSION OF
THE STATE OF CALIFORNIA**

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**NOTICE OF EX PARTE COMMUNICATION OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION**

In accordance with CPUC Rule 1.4, the California Independent System Operator (CA ISO) respectfully submits this Ex Parte Notice. On March 27, 2003, from 2:30 to 4:00 PM, Robin Smutny-Jones, Director of State Affairs, Keith Casey, Manager of Market Analysis and Mitigation, Robert Sparks, Lead Grid Planning Engineer in the Grid Planning Department of the CA ISO, and Jeanne M. Solé, Regulatory Counsel for the CA ISO, met with the following advisors: Kevin Coughlan, David Gamson, Lynne McGhee, and Laura Krannawitter to discuss the Proposed Decision of ALJ Gottstein (“Proposed Decision”) and the Alternate Decision of Commissioner Lynch (“Alternate”) in the above referenced proceeding. Ms. Solé attended by teleconferencing. The meeting was arranged at the request of David Gamson.

The communications on the part of CA ISO attendees were as follows:

The CA ISO disagrees with the portrayal in the Proposed Decision and the Alternate that the Path 15 upgrade is only economic in extreme worst-case scenarios. Rather, the CA ISO believes that the record shows that the benefits are substantial even in

a reasonable scenario. The upgrade can pay for itself within four normal hydro years even applying a plus or minus 25% factor.

While the Proposed Decision and Alternate are not completely clear in all cases on the rationale for their conclusions, there are two lines of argument for the portrayal that the upgrade is only economic in extreme circumstances. First, the Proposed Decision and Alternate stress that regulation should control market power. While they appear to accept that certain other structural approaches are acceptable to control market power, such as demand response and long-term contracting, the Proposed Decision and the Alternate dismiss use of transmission upgrades to control market power. The CA ISO strongly agrees that regulators should seek to control market power. At the same time, however, the CA ISO considers that regulators should additionally support structural changes to control market power including cost-effective transmission. The Proposed Decision suggests that because market power should be controlled by regulation, the results of whether or not an upgrade is economic should be evaluated using the first part of the CA ISO's study which assessed cost effectiveness assuming a perfectly competitive market. If one makes this assumption, then the Path 15 upgrade is not cost-effective except in extreme circumstances. However, the CA ISO does not consider that it is appropriate to assume a competitive market. Whether or not the market will be competitive depends on whether or not the structural elements are put into place to support a competitive market, one of which would be the Path 15 upgrade.

Also, the Proposed Decision and the Alternate mischaracterize the CA ISO's study and position. For several factors, such as long-term contracts and ETC capacity that will remain unused, the CA ISO presented extreme scenarios as bookends – i.e. one

bookend represented a scenario that would over estimate benefits and another bookend represented a scenario that would under estimate benefits. The CA ISO presented in testimony and briefs its view about what the reasonable assumption would be between these bookends based on evidence as it was developed in testimony and hearings. The CA ISO then used the bookend information and the reasonable assumption position to estimate benefits and applied a plus or minus 25 % factor to account for uncertainties. The Proposed Decision and Alternate dismiss the bookend scenarios that would over-estimate the benefits and then argue that the upgrade is cost-effective only in extreme scenarios by considering only the scenarios that would under-estimate the benefits. The Proposed Decision and Alternate did not discuss scenarios between the two extremes, which are the ones that the CA ISO considers to be most reasonable.

The CA ISO explained that the record in the case does indicate that Path 15 is not needed to meet WECC and NERC planning reliability criteria. The CA ISO explained that in response to Commissioner Lynch's ruling directing PG&E to file for a Certificate of Public Convenience and Necessity for a Path 15 upgrade, PG&E and the CA ISO divided up the work to assess the need for the upgrade, PG&E undertook the reliability assessment and the CA ISO undertook the economic assessment. The CA ISO stated that it believes the PG&E assessment looked at year 2005 because this is the soonest the project could be in service. The CA ISO noted that even if it is not strictly needed to meet WECC and NERC planning reliability criteria, the Path 15 upgrade would have reliability benefits. It would allow CA ISO operators more flexibility operating the system. Moreover, the CA ISO explained that the evidence indicates that a RAS scheme which supports the current path rating includes dropping a substantial level of load in

certain double contingencies. Moreover, the evidence shows that if the path is upgraded, the RAS scheme would change but a significant level of load would still be subject to being dropped in double contingencies. However, the CA ISO explained that if future Path 15 usage levels do not consistently result in maximum 5400 MW flows the upgrade would provide reliability benefits by allowing the CA ISO to reduce the level of load subject to the RAS. The CA ISO pointed out that, currently, the Path 15 segment of the Pacific Intertie is the only segment that relies on firm load shedding to meet reliability requirements for N-2 outages. These are examples of reliability benefits that would result from a Path 15 upgrade.

The CA ISO also explained that it is required by state law and its tariff to apply the WECC and NERC standards. The CA ISO noted that the WECC and NERC standards are deterministic which means that they need to be met, they do not provide for an economic analysis of whether or not they should be met. However, the CA ISO explained that the deterministic standards are designed to require better system performance for more likely contingencies which was itself based on probabilistic analysis. The CA ISO also explained that once a need has been identified, the CA ISO seeks the best value solution to meet the need.

The CA ISO clarified that issues associated with ETCs do not tend to arise in the context of a reliability assessment for an internal path that is part of the CA ISO Controlled Grid such as Path 15 because the CA ISO can use transmission capacity within the CA ISO Controlled Grid that is subject to ETCs in real time even in cases where the capacity must be reserved for ETC rights holders in the Day-Ahead and Hour-Ahead markets.

The CA ISO explained the assessment it undertook of the market power mitigation benefits of upgrading Path 15. The CA ISO explained that using data from November 1999 to October 2000, the CA ISO was able to establish a relationship between price-cost markups and certain key variables such as load, and the level of capacity controlled by the largest supplier. The CA ISO used that relationship to estimate price-cost markups in 2005, based on the load and supply conditions that were projected in 2005. Thus, the CA ISO did not assume there would be market power in 2005, it merely assumed that in 2005 the relationship between load, supply controlled by the pivotal generator and price-cost markups would be the same as it was in the November 1999 to October 2000 time frame. The CA ISO explained that it used this time frame precisely because it includes a range of conditions, including conditions in which the market was operating fairly well.

The CA ISO stressed that its study was properly validated. The CA ISO referred the advisors to its comments on the Proposed Decision and the Alternate for a discussion of the statistical validity of the study. The CA ISO also noted that the validation required by the judge confirmed the validity of the study and demonstrated that there is no bias in the study that results in an overestimate of the benefits.

The CA ISO once again explained that the cases it presented were bookend cases. The CA ISO explained that as to the CDWR long-term contracts, the CA ISO assessed a scenario without long-term contracts because at the time the study was being conducted, there was talk of abrogating the long-term contracts. The CA ISO explained that during the hearings, the CA ISO became aware that less than half the capacity subject to long-term contracts is firm. The CA ISO explained that for this reason, the CA ISO believes

that the reasonable case as to long-term contracts is one that assumes 50% of the load covered by long-term term contracts will be shielded from the impacts of market power. The CA ISO explained that its assumptions of the ETC capacity that would remain unused was based on historic information and the ETC contracts that will expire in the next several years. The CA ISO also stressed that after the study was completed there was a significant slow down in the addition of new generating capacity and that the medium generation case that the CA ISO had initially supported was probably too high. The CA ISO noted that even the mid-point between the medium and low generation cases which the CA ISO supported in its briefs is probably too high.

The CA ISO stated that it did not file briefs on whether PG&E requires a CPCN for undertaking the project in conjunction with TransElect and WAPA. The CA ISO stated that PG&E and ORA filed briefs on the matter.

The CA ISO also explained that after the hearings were concluded and the briefs were submitted to the CPUC, the CA ISO presented the project to its governing board. The CA ISO explained that the project was not presented earlier because unlike most projects, review before the CPUC commenced in response to a ruling by Commissioner Lynch which set forth a very aggressive schedule for filing of a CPCN by PG&E. (Ordinarily, projects are considered in the CA ISO Grid Planning process and presented to the CA ISO Governing Board before a CPCN application is submitted to the CPUC.) Thus, the CA ISO focused on participating in the CPUC proceeding. The CA ISO did present the project to its governing board in summer 2002 and the project was unanimously approved by the CA ISO Governing Board. In approving the project, CA ISO Governing Board Chairman Kahn stressed to staff that in addressing the project to

other agencies and the public, the CA ISO needs to stress the reliability benefits of the upgrade in addition to the economic benefits.

Dated at Folsom, California, this 1st day of April, 2003

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