UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket No. ER04-835-000**
Pacific Gas and Electric Company	)	
v.	)	
California Independent System Operator Corporation	)	**Docket No. EL04-103-000 (consolidated)**

BRIEF OPPOSING EXCEPTIONS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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Table of Contents

TABLE OF AUTHORITIES

COMMISSION DECISIONS

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Pursuant to Rule 711 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.711, the California Independent System Operator Corporation ("ISO")[1] respectfully submits its Brief Opposing Exceptions. This proceeding concerns the Initial Decision on Amendment No. 60 to the ISO Tariff, *California Independent System Operator Corporation*, 113 FERC ¶ 63,017 (2005) ("Initial Decision" or "ID"). Under Amendment No. 60, the ISO proposed to revise the allocation of charges for the Minimum Load Cost compensation ("MLCC") paid to generators that are denied waivers of the must offer obligation.

[1] Capitalized terms not otherwise defined are used in the sense given in the Master Definitions Supplement, ISO Tariff Appendix A.

I. EXCEPTIONS OPPOSED

The ISO opposes the following Exceptions to the Initial Decision filed by Pacific Gas and Electric Company ("PG&E"), Powerex, Southern California Edison Company ("SCE"); the Sacramento Municipal Utility District ("SMUD"); the Cities of Anaheim, Azusa, Banning, Colton, and Riverside ("Southern Cities" or "SOC"); the Commission Trial Staff ("Staff"), and the State Water Project of the California Department of Water Resources ("SWP").

Party	Exception No.	Exception
PG&E	2	The Initial Decision accepts a "net incremental cost of local" approach to allocating the [Must Offer Waiver Denial] costs allocated to the local bucket. Without citation, the Initial Decision holds that "Commission policy and the record in this proceeding overwhelmingly support the net incremental cost of local approach." ID at P 120. This holding is unsupported and erroneous. PG&E takes exception to this holding because PG&E, the California Public Utilities Commission ("CPUC"), the Independent Energy Producers Association ("IEP") and the Southern Cities all demonstrated at hearing that the net incremental cost of local approach is a self-serving proposal that was developed by, and solely benefits, SCE. As such, it is discriminatory and preferential, notwithstanding the Initial Decision's unsupported conclusion to the contrary. ID at P 121.

PG&E	4	The Initial Decision summarily finds that the issue of the proper allocation of start-up and emissions costs is beyond the scope of this proceeding. ID at P 133. The Commission's orders in these proceedings compel no such conclusion, and logic and consistency dictate that if a more accurate, more reasonable allocation methodology is adopted for MLCC costs, and that same allocation approach can readily be applied to start-up and emissions costs, the more accurate, more reasonable methodology be employed. Moreover, PG&E squarely raised that issue in its Section 206 complaint filed in Docket No. EL04-103-000. PG&E has demonstrated that the ISO can readily apply the three bucket allocation approach to start-up and emissions costs and bring them into line with how MLCC costs are allocated under Amendment No. 60. Therefore, there is no reason for the Commission not to order that this consistent allocation approach be applied.
Powerex	1	The Initial Decision erred in finding that deviations in import schedules should be allocated system MLCC costs because the CAlSO considers only deviations between day-ahead schedules and historical hour-ahead schedules when it incurs the MLCC costs, but allocates costs based on deviations in schedules between the hour-ahead and real time; where historical data on deviations between hour-ahead and real time is not considered when the CAlSO incurs MLCC costs, such deviations cannot be said to cause or benefit from the incurrence of MLCC costs.
Powerex	2	The Initial Decision erred in finding that imports cause and benefit from the incurrence of system MLCC costs where (a) there is no nexus between deviations in import schedules and the incurrence of the MLCC costs, and recent CAlSO documents show that imports do not cause MLCC costs, and (b) there is no record evidence showing the precise benefit to imports for the incurrence of MLCC costs.

Powerex	3	The Initial Decision erred in rejecting Powerex's alternative proposals to allocate costs to load based on a 5 percent scheduling deviation or to not impose MLCC costs on deviations in import schedules where the deviation is outside of the reasonable control of the Scheduling Coordinator; (a) the record evidence supports Powerex's proposal, which is consistent with the Commission's recent order accepting CAlSO tariff Amendment No. 72 that imposes a 95 percent day-ahead scheduling requirement, or (b) at minimum, where deviations in import schedules are due to force majeure events, those deviations should not be allocated MLCC costs, since a deviation outside of a Scheduling Coordinator's control necessarily cannot be said to "cause" the incurrence of costs.
SCE	1	The I.D. erred in finding and concluding that the Attachment E criteria satisfy the just, reasonable and not unduly discriminatory standard with respect to Commission policy on cost causation and benefits received. I.D. at P 87.[2]
SCE	2	The I.D. erred in finding and concluding that "the only MLCC cost allocation alternative that potentially satisfies the just, reasonable and not unduly discriminatory standard is the Amendment No. 60/Attachment E alternative." I.D. at P 116.
SCE	6	The I.D. erred in stating that the "constraints that produce zonal MLCC costs, in contrast, are inter-zonal interfaces which by definition cannot be confined to a single PTO service area and which provide benefits throughout the zone." I.D. at P 94.
SCE	9	The I.D. erred in adopting a July 17, 2004 effective date given that the ISO's incremental cost of local methodology, that it found to be just, reasonable, and not unduly discriminatory, could not be implemented back to July 17, 2004. I.D. at PP 119 n. 83, 122.

[2] SCE Exceptions 1, 2, and 6 appear to be directed not so much at Attachment E generally, but at the Initial Decision's application of Attachment E to the South of Lugo constraint. The ISO has not taken Exception to the Initial Decision's application of Attachment E to South of Lugo, but the ISO does not oppose these Exceptions to the extent they do so. The ISO does oppose these Exceptions to the extent that they are taken as a general objection to the Attachment E criteria.

SCE	10	The I.D. erred in concluding that Stipulation No. 3, which was not signed by all parties, resolved whether the pre-Amendment No. 60 methodology was just, reasonable, and not unduly discriminatory as of July 17, 2004. I.D. at P 140.
SCE	11	The I.D. erred in noting "that net incremental local costs should not be used to calculate refunds for the period from July 17,2004 through September 30, 2004. I.D. at P 141.
SCE	12	The I.D. erred in its failure to implement the incremental cost methodology for determining Zonal costs. I.D. at P 118.
SMUD	A	The Presiding Judge erred in finding that wheel-throughs derive sufficient benefit from reliable grid operation to justify an MLCC allocation when the Presiding Judge has contemporaneously found that there is an insufficient cost causation nexus to allocate system MLCC to wheel-throughs;
SMUD	B	The Presiding fails to make a rational connection between the facts found and choices made in summarily finding that there are sufficient benefits to justify an MLCC allocation to wheel-throughs without answering SMUD's evidence that there are insufficient benefits;
SMUD	C	The Presiding Judge erred in justifying an allocation of "minimal level" of costs, because a modest impact cannot justify an unlawful allocation;
SMUD	D	The Presiding Judge erred in justifying an allocation of system MLCC to wheel-throughs, in part, on a finding, without substantial evidence, that wheelthroughs' share of system MLCC would be "minimal;"
SMUD	E	The Presiding Judge erred in finding that he could not, outside of pure speculation and arbitrary and capricious decision-making, determine that the Reliability Services Cost definition is superfluous, unduly vague, overbroad and open to undue CAISO discretion.
SOC	2	The Initial Decision inaccurately finds that the Southern Cities proposal to allow SP15 LSEs to avoid SCIT-related MLCC costs by self-providing local generation inertia is infeasible and not cost-effective.
SOC	3	The Initial Decision errs in its determination that the ISO's "incremental cost of local" approach for reallocating Local MLCC costs to the System bucket is consistent with the Commission's cost causation principles and should therefore be accepted.

SOC	4	The Initial Decision errs in finding that no participant objects to a 50/50 allocation between buckets for MLCC costs that the ISO erroneously attributed to more than one transmission constraint and in finding that the 50/50 dual allocation proposal is reasonable.
Staff	3	The Presiding Judge erred by ignoring Commission precedent that requires that a consistent methodology be used to allocate MLCC, Emissions and Start-Up costs.
SWP	I	The Initial Decision is arbitrary, capricious and fails standards of reasoned decisionmaking insofar as its departure from the Joint Statement of Contested Issues caused it to omit meaningful consideration of contested issues raised in briefing, and to rule upon matters neither at issue nor raised on brief.
SWP	I.A	Because the ID strays from the Joint Statement of Contested Issues and therefore fails to provide meaningful consideration of the contested issues raised in briefing—and decides issues not raised—the Commission should review de novo the issues raised on brief by the parties.
SWP	II	The Initial Decision should be reversed because it defies governing tariff language and precedent in allocating to service under Existing Transmission Contracts Zonal must offer generation costs incurred, according to the tariff, "due to Inter-Zonal Congestion".
SWP	II.A	The ID errs in disregarding tariff language requiring that firm ETCs must be honored.
SWP	II.B	The ID errs in disregarding Commission precedent that firm ETCs cannot be forced to bear additional reliability costs absent unbundling and contract revision.
SWP	II.C	The ID makes reversible factual errors in attributing to firm ETC service—which the CAISO is not supposed to curtail—an "extracontractual benefit" of reduced curtailments.
SWP	II.D	The ID fails filed rate doctrine requirements in eschewing clear rate language in favor of a perceived suggestion distinguishing costs "due to Inter-Zonal Congestion" and costs of Inter-Zonal Congestion as a basis for charging FERC-regulated rates.
SWP	II.E	The ID impermissibly disregards Commission precedent holding that the purpose of the cost—and not the CAISO's new name or description of that cost—determines cost allocation.

SWP	III	The Initial Decision errs in allocating costs based on imputed benefits, eliminating meaningful price signals to loads, and thus thwarting demand response in contravention of Federal law and Commission policy.
SWP	III.A	The ID erroneously departs—without adequate explanation—from the Commission's Hearing Order in this matter, using imputed benefits as opposed to following the principle that the entities that cause costs should pay those costs.
SWP	III.B	The ID's reliance on imputed benefits impermissibly ignores Federal law and Commission policy mandating consideration of demand response based on time-sensitive pricing, as well as record evidence that reducing peak demand could reduce the need for Amendment 60 costs.
SWP	III.B.1	The ID commits error of fact in failing to recognize that must offer costs are incurred to meet the CAISO's forecast of peak load, leading to a failure to address the statutory "policy of the United States that time-based pricing and other forms of demand response, whereby electricity customers are provided with electricity price signals and the ability to benefit by responding to them, shall be encouraged."
SWP	III.B.2	The ID's reliance on imputed benefits for purposes of cost allocation impermissibly raises barriers to demand response.
SWP	III.B.3	The Initial Decision fails standards of reasoned decisionmaking insofar as it offers no analysis of cost incurrence that might permit time-sensitive rates, yet rejects SWP's identification of the hours driving must offer generation waiver denials.
SWP	III.B.4	The ID erroneously fails to consider the ease of administration associated with SWP's 5-hour definition of peak hours, which captures the range of hours actually evaluated by the CAISO denying must offer waivers.
SWP	III.B.5	The ID erroneously fails to acknowledge that the WECC/NERC definition of on/off-peak hours bears no correlation to Amendment 60 cost incurrence.
SWP	III.B.6	The ID erroneously fails to consider the alternative of using a WECC on-/off-peak definition as a means of permitting some opportunity for time-sensitive rates, consistent with governing policies.
SWP	III.C	The Initial Decision should be reversed as misconstruing governing FERC precedent and policy endorsing locational cost allocation of reliability-related services designed to send price signals to affected loads.

SWP	III.C.1	The ID fails standards of reasoned decisionmaking by failing to recognize that must offer generation costs are incurred to meet demand in particular locations, notably the Los Angeles Basin, which contains no major pump loads.
SWP	III.C.2	The ID commits factual error in disregarding unrefuted CAISO evidence concerning the administrative ease of allocating costs locationally by Load Groups to exclude pump load that does not cause must offer generation costs.
SWP	III.C.3	The outcome of the ID erroneously results in undue discrimination, in that it concludes that charging PG&E load for Amendment 60 costs it does not cause is unjust and unreasonable, but that charging similarly situated SWP load is permissible.
SWP	III.C.4	The ID impermissibly ignores applicable precedent holding that if the CAISO can feasibly avoid allocating costs to those who do not cause them, it is unjust and unreasonable to continue allocation by socialization.
SWP	IV	If a benefits approach is used, the Initial Decision's analysis of benefits, as applied to SWP pump load, should be reversed because it erroneously falls short of its own analytical framework in terms of degree of benefit, fails national policy requiring recognition of demand response, and neglects to address contested issues.
SWP	IV.A	The ID states that the degree of benefit must be examined, yet fails to identify benefits to SWP load, which is treated as interruptible, failing standards of reasoned decisionmaking.
SWP	IV.B	The ID errs in failing to address record evidence that SWP pump loads are regularly dropped in order to protect other, firm loads.
SWP	IV.C	The ID erroneously neglected to address Commission precedent that CAISO and SCE treatment of SWP pump load meets Commission standards for interruptible load for purposes of cost allocation.
SWP	IV.D	In ignoring treatment of SWP pump loads as a demand response resource, the ID erroneously disregarded national policy requiring recognition of the benefits of demand response.

II. SUMMARY

The ISO believes that the Initial Decision is well reasoned and provides its own response to the majority of the arguments raised by parties in their Briefs on Exceptions. The ISO does not intend to provide additional arguments in response to Exceptions PG&E 2, SCE 1-2, 6, SOC 3-4, and SMUD A-E. With regard to other Exceptions, the ISO will attempt to limit its response to matters not fully covered in the Initial Decision or on which it believes that it can otherwise assist the Commission in its review of the Initial Decision.

- Contrary to SWP's argument, use of Amendment 60 supplemented with the Attachment E criteria as an alternative to Amendment 60 as filed was clearly identified in the Joint Statement of Contested Issues and briefed by the parties.
- The Initial Decision properly concluded that Commission precedent disfavors piecemeal reform of market structures and, in light of the ISO's pending Market Redesign and Technology Update, does not require subzonal allocation of Zonal MLCC costs.
- The ISO Tariff fully supports charging Zonal MLCC to Demand served by an Existing Contract. Such charges are not precluded by the requirement to honor Existing Contracts because, even if units are committed to address potential real time Inter-Zonal Congestion, they are not Congestion charges. Congestion Management procedures, and the charges related to those procedures, appear in Sections 7.2 and 7.3 of the ISO Tariff. MLCC charges appear in Section 5.11.6.1.2 of the ISO Tariff. Similarly, there is no validity to SWP's argument

that the ISO Tariff must specify the allocation to Existing Contracts. Demand served by Existing Contracts unambiguously falls within the allocation to "Demand" within the Zone specified, as specified in the allocation of Zonal MLCC in Section 5.11.6.1.2.

- Allocation of Zonal MLCC to Demand served by an Existing Contract is consistent with Commission precedent because the charges reflect a new service not provided under the Existing Contracts.
- In light of the minimal prospective time horizon of the charges at issue and the limited ability of parties to respond to any price signals that might be sent by time-sensitive MLCC charges, considerations of demand response do not require the implementation of time-sensitive MLCC charges.
- There is no evidence to support SWP's argument that its pump loads are interruptible such that they do not benefit from must offer Generation and should be exempted from Zonal MLCC.
- Although Powerex's proposed allocation of System MLCC may be just and reasonable, the Attachment E allocation approved by the Initial Decision is also just and reasonable. Because of the expenditure of resources that would be necessary to implement the Powerex alternative, the Commission should affirm the Initial Decision.
- Southern Cities' arguments that the Initial Decision's rejection of its proposal for the self-provision of inertia relied upon discredited testimony are misplaced. In each instance, the Initial Decision properly that the proposal that would raise

issues concerning implementation or cost-effectiveness.

- Regardless of whether the allocation of Start Up and Emissions costs are within the scope of the proceeding, no party has made a showing that the current allocation is unjust or unreasonable. There is therefore no basis to reverse the Initial Decision's conclusion not to apply the Amendment No. 60 methodology to Start Up and Emissions Costs. If the Commission decides to review these costs, the ISO has no objections to the proposals for allocating Start Up costs. The proposals to allocate Emissions Costs, however, are problematic because the ISO cannot isolate Emissions Costs related to must offer waiver denials from other Emissions Costs of Must Offer Generators.
- The ISO's stipulation established that the allocation of MLCC costs was unjust and unreasonable from July 17, 2004, to September 30, 2004. The concurrence in the stipulation by intervenors was not necessary.
- The net incremental cost methodology for Local MLCC cannot be implemented for the period prior to October 1, 2004. The methodology described in Exh. ISO-22, pp. 40-42, could be implemented if the Commission so decides. The ISO agrees with PG&E that the Initial Decision is unclear regarding the implementation of the alternative methodology and needs to be clarified.

III. REBUTTAL OF POLICY CONSIDERATIONS WARRANTING REVIEW

The ISO's substantive responses to the issues raised in the various "Policy Considerations Warranting Review" are contained in its argument below. The ISO does not present them here because the ISO believes that the issues are of sufficient import

that Commission review is appropriate.

IV. ARGUMENT

As a general matter, the ISO believes that the Initial Decision is well-reasoned and fully supported by the record and provides its own response to the majority of the arguments raised by parties in their Briefs on Exceptions. Accordingly, the ISO does not intend in this Brief to attempt to respond to every argument raised in Briefs on Exceptions. Indeed, the ISO believes that no response, other than the reasoning of the Initial Decision itself, is required with regard to Exceptions PG&E 2, SCE 1-2, 6, SOC 3-4, and SMUD A-E. With regard to other Exceptions, the ISO will attempt to limit its response to matters not fully covered in the Initial Decision or on which it believes that it can otherwise assist the Commission in its review of the Initial Decision. The ISO has attempted to indicate the issues as identified in the Initial Decision ("ID") and as identified in the Joint Statement of Contested Issues ("JSCI"), as well as the Exceptions, to which the ISO is responding.

A. The Initial Decision Properly Evaluated Amendment No. 60 Supplemented by Attachment E as an Alternative to Amendment No. 60 as Filed. (ID Issue 3; JSCI Issues I.A, II.A; SWP Exception I)

After determining that the ISO had failed to meet its burden of proving that Amendment No. 60 was just and reasonable, the Initial Decision evaluated Amendment No. 60, supplemented by Attachment E to the ISO's Amendment No. 60 filing, as an alternative to Amendment No. 60 standing alone. SWP suggests in numerous places that this was improper because Attachment E was not identified in the Joint Statement of Contested Issues or briefed as a potential alternative. SWP Br. at 5-6, 9-10, 26-27, 33.

To the contrary, Issue II.A of the Joint Statement of Contested Issues was "Whether Attachment E as included in the ISO's original filing of May 11, 2004 should be deemed part of Amendment 60 to the ISO Tariff as filed." Issue II.B was "Whether the criteria used by the ISO to classify units committed under the Must Offer Wavier Denial (MOWD) process should be included in the ISO Tariff." In its Brief, the ISO explained the complication introduced by its failure to include Attachment E as part of the tariff amendment and its desire that Attachment E be treated as part of the tariff amendment:

> The exception mentioned above [to the lack of complicated principles in the hearing] involves Attachment E to the ISO's May 11 Filing, which includes the criteria that the ISO proposed to use to assign MLCC to each of the three proposed cost categories. The ISO did not propose to make this attachment part of the ISO Tariff, but in its Testimony the ISO has expressed a willingness to include it in the ISO Tariff. Much of the controversy in this proceeding involves the criteria in Attachment E. Because the ISO has made a proposal, but not as part of the tariff, and the inclusion of the Attachment E criteria as proposed or modified in the tariff could be part of a compliance order in this proceeding, it is unclear where the burdens lie regarding the criteria and language of Attachment E. One possible solution – which the ISO endorses below – is to deem Attachment E a part of Amendment No. 60 to the ISO Tariff.

ISO Initial Br. at 8. Later, the ISO noted that such treatment would "facilitate including these criteria as part of what constitutes its proposal in this proceeding, and as subject to a refund effective date of July 17, 2004." *Id.* at 43. SWP argued against deeming Attachment E as part of the tariff filing. SWP Initial Br. at 61-62. It could not have been more apparent that Attachment E was not just an "explanatory gloss," SWP Initial Br. at 33, but was the ISO's proposed allocation.

Indeed, the Joint Statement of Contested Issues reflected that fact. Issue I.C was "Should MLCC costs be allocated, pursuant to the criteria used by the ISO to classify units committed under the Must Offer Wavier Denial (MOWD) process as set forth in Attachment E of the ISO's filing of May 11, 2004, to each of the Local, System, Zonal categories, or should they be allocated in another manner or to other categories?" Each of the parties briefed the use of the Attachment E criteria. SWP argued against the use of the Attachment E criteria, which it referred to, not as "an explanatory gloss," but as "the ISO's mechanism." SPW Initial Br. at 21.

B. The Initial Decision Properly Endorsed the Allocation of Zonal MLCC to Zonal Demand Based on the Benefits Received. (ID Issues 1, 3; JSCI Issues I.A, I.C; SWP Exceptions III.A, III.C)

SWP asserts that the Initial Decision "misconstrues governing FERC precedent and policy endorsing locational cost allocation of reliability services so as to send price signals to affected loads" and rather "seizes upon the word 'benefit' in [*PJM Interconnection, L.L.C.*[3] ("*PJM*")] to endorse Amendment 60's broadly spread uplift charges based on a concept of presumed collective benefit." SWP Br. at 55. Of course, the Initial Decision did nothing of the kind. In response to the Commission's directive that the Amendment No. 60 allocation should reflect cost causation, the Initial Decision engaged in a careful and lengthy analysis of the Commission's policy on cost causation, correctly concluding that "an entity may be deemed to have caused costs *either* if it is directly responsible for imposing the cost burden at issue *or* if the entity benefits from the

[3] 107 FERC ¶ 61,112 (2004), *on reh'g*, 110 FERC ¶ 61,053, *on reh'g*, 112 FERC ¶ 61,031 (2005).

cost incurrence." ID at P 39.[4] The Initial Decision's reference to the term "benefits" in *PJM* was simply part of its explanation that SWP had oversimplified the relationship of those orders and the case at hand, as it does in its Brief on Exceptions.

The Initial Decision quite properly explained the difference between long term and short term reliability issues in *PJM,* and concluded that, in light of the forthcoming implementation of the long-term remedies of MRTU, piecemeal reforms such as locational allocation of MLCC would not be appropriate. I.D. at PP 40-42. Contrary to SWP's assertion, the Presiding Judge did not conclude that the Commission's "overarching analytical approach" in *PJM* can be "deferred." SWP Br. at 58. The Commission's overarching analytical approach is not a method of cost allocation, it is rather what it purports to be: a method of analysis. In *PJM* the Commission stated:

> [T]he Commission has determined that there is not necessarily a standard regulatory response to [Reliability Compensation Issues]. The Commission will, however, employ an overarching analytical approach which will institute a consistent and disciplined way of looking at these issues and arriving at an effective result for the organized market in question. In undertaking our analysis and arriving

[4] The Initial Decision even engaged in a critique of the policy, concluding that causal responsibility appears to be imputed, and costs allocated, to any identifiable beneficiary that has not paid for the benefit received, most likely to obviate/remediate any potential subsidization, windfall, or free rider problem. ID at P. 44. The ISO believes the relationship between cause and benefits is more direct. As the ISO noted in its Reply Brief at 2, as a regulated public utility providing transmission subject to the Commission jurisdiction, the ISO must justify its costs as the cost of providing that transmission service. In other words, the ISO incurs costs in order to provide transmission service, *i.e.*, to provide the benefits to the users of the transmission system. Each of the users of the system thus causes the ISO to incur costs.

> at our solution, we will take account of the present circumstances and expected future needs of each market. Thus, while "one size might not fit all," the approach for determining the right path to solve Reliability Compensation Issues should be both uniform and transparent."

107 FERC ¶ 61, 112 at P 15. That approach includes the separate consideration of short-term and long-term issues. *Id.* at P 16. This is precisely the analysis the Initial Decision undertook. The fact that the Commission referred to *PJM* in its order setting Amendment No. 60 for hearing, SWP Br. at 57, does not require the Presiding Judge to accept SWP's simplified interpretation of *PJM*.

A similar problem arises with SWP's reliance on *Devon Power LLC*, 109 FERC ¶ 61,156 (2004), *on reh'g* 110 FERC ¶ 61,313 (2005). In its Brief on Exceptions, SWP completely ignores the most salient point noted in the Initial Decision–the Commission's rejection of piecemeal changes. *Devon* concerned the implementation of a locational installed capacity ("LICAP") program as directed by the Commission and the designation of installed capacity ("ICAP") regions, as well as the relationship of LICAP regions to energy load zones. *Devon Power LLC*, 107 FERC ¶ 61,240 at PP 1-2. The Commission did not direct ISO New England to develop more granular pricing signals, but set for hearing the proposal for a single LICAP region for Connecticut, directed ISO New England to investigate whether a LICAP region was necessary for Southwest Connecticut, and initiated a Section 206 investigation on whether an energy load zone should be implemented for Southwest Connecticut to correspond with the LICAP region, if one were established. *Id*., Ordering paragraphs (D), (E). Subsequently, ISO New England determined a separate LICAP region was necessary, presenting a detailed and

complex analysis. Over protests, the Commission subsequently approved the region. 109 FERC ¶ 61,156 at P 25.

What is apparent and critical is that the entire debate and process in *Devon* involved the development of a new reliability and zonal structure concurrently with the pricing structure, much as is occurring in MRTU. What SWP neglects to note is that the Commission specifically declined to implement parts of the pricing structure piecemeal. The Commission observed:

> [T]he ISO-NE states that a separate energy load zone must be created for SWCT if a SWCT ICAP region is created. . . . *ISO-NE recommends establishing a separate energy zone for SWCT simultaneously with, and not before, the implementation of establishing a separate ICAP region for SWCT. First, ISO-NE states that, as a practical matter, it could not implement a separate SWCT energy zone much before implementation of a SWCT ICAP region. . . . Additionally, ISO-NE references its report on nodal pricing, stating that current energy price differentials alone do not justify establishing a separate SWCT energy zone at the present time if a separate ICAP region is not also created.*

Id. at P 15 (emphasis added). It went on to state:

> The Commission raised this question because we initially believed that implementation of a separate energy load zone early would provide better price signals during the interim period before LICAP is implemented. ISO-NE's analysis has shown that these benefits are not substantial enough to justify establishing the zone early. Additionally, ISO-NE states that it could not practically implement a separate SWCT energy zone much before January 1, 2006. As a result, we conclude that it would be advantageous to implement both the separate ICAP region and the separate energy load zone on the same date.

Id. at P 38.

SWP itself acknowledges that the settlement system capable of allocating the cost at a subzone level will not be available until the second quarter of 2006. SWP Br. at 62. About that time, the California Public Utility Commission's Resource Adequacy Requirement will become applicable. The must offer obligation may well terminate at that time, and no later than the implementation of MRTU. The Initial Decision properly recognized that issues of locational, including subzonal, allocation are properly addressed through the MRTU process and not by requiring the ISO to make a short term, resource intensive, piecemeal revisions of its settlement structure at the same time it is attempting to finalize MRTU.

C. The Initial Decision Properly Concluded that Existing Contract Schedules Should Not Be Exempt from Zonal MLCC When a Unit Is Committed to Combat Potential Real Time Inter-Zonal Congestion. (ID Issue 3; JSCI Issue I.F; SWP Exception II)

1. Nothing in the ISO Tariff Precludes Allocation of Zonal MLCC to Demand Service by Existing Transmission Contracts.

SWP makes two variants of an argument that the ISO is not authorized under the tariff to allocate Zonal costs to demand served by an Existing Contract ("ETC"). First, based on tariff language that Zonal costs are "due to Inter-Zonal Congestion" [5] SWP contends the demand served by ETCs cannot be allocated Zonal MLCC because the Commission has prohibited the ISO from charging ETCs "congestion charges *of any kind*." SWP Br. at 30. Second, SWP asserts that the ISO Tariff provides no basis

[5] As discussed above, and contrary to SWP's contention, the Presiding Judge properly evaluated Attachment E as an alternative. Under Attachment E, one or multiple categories of Zonal MLCC involves units committed due to Inter-zonal Congestion.

charging Zonal MLCC to demand served by ETCs. SWP Br. at 34.

The Initial Decision properly based its decision on the distinction between generation costs incurred in anticipation of real-time Inter-Zonal Congestion and congestion charges. In challenging the Initial Decision, SWP never identifies a tariff provision that equates MLCC with Inter-Zonal Congestion charges. All it can point to is the inability of the ISO's witnesses to identify a tariff provision that distinguishes the two and a statement by a Staff witness that nothing in the ISO tariff expressly authorizes the allocation of Amendment No. 60 charges to ETC service. SWP Br. at 33.

With regard to the former, it would be strange indeed if the ISO Tariff included provisions that gratuitously explained the difference between the various types of ISO charges. Further, nothing is proved by the ability or inability of lay witnesses to explain the tariff. Rather, the difference between Congestion charges in general (including Inter-Zonal Congestion charges) and MLCC is apparent from the fact that the ISO's Congestion Management procedures, and the charges related to those procedures, appear in Sections 7.2 and 7.3 of the ISO Tariff. See, e.g., § 7.2.1.5 (Elimination of Real-Time Inter-Zonal Congestion); § 7.3.1 (Usage Charge of Inter-Zonal Congestion); § 7.3.2 (Grid Operations Charge for Intra-Zonal Congestion) (Item by reference 1 at Sheets 199, 207, 212). MLCC charges appear in Section 5.11.6.1.2 of the ISO Tariff (Item by reference 1 at Sheet 184E).

The difference between congestion charges and MLCC costs is controlling. The Commission language prohibiting the ISO from allocating "congestion charges of any kind" to ETCs appears in an order approving the ISO's creation of a new Zone.

California Indep. System Oper. Corp., 89 FERC 61,229 at 61,681-82 (1999). Certain parties with Existing Contracts wished confirmation that their exemption from Usage Charges would apply to Usage Charges between the new Zone and the existing Zones. *Id*. The Commission's reference to "congestion charges *of any kind*" must be read in this context to refer to the previous and new Usage Charges. The emphasis is SWP's, not the Commission's.

SWP's contention that Amendment No. 60 fails the filed rate requirement because it fails to inform Existing Rightholders that they will be charged for Zonal MLCC when a unit is committed to address potential Inter-Zonal Congestion, SWP Br. at 34, fairs no better. SWP bases this argument on the fact that Amendment No. 60 nowhere contains the words Existing Transmission Contracts or ETCs. There is no reason to mention ETCs, however. Amendment No. 60 provides that Zonal MLCC will be allocated to all Demand in the Zone. Section 5.11.6.1.2 of the ISO Tariff (Item by reference 1 at Sheet 184E). The only reason to mention ETCs would be if Amendment No. 60 were exempting ETCs, which it does not. The language is clear on its face.

SWP asks why contracts providing firm, non-curtailable transmission service receive an extra-contractual benefit from a reduction of the potential for curtailment, as the Initial Decision found. SWP Br. at 35. That explanation was provided in the ISO's Initial Brief. It is because Existing Contracts usually provide the Existing Rightsholder with scheduling rights that the Existing Rightsholder is exempt from Usage Charges (congestion charges in the Day-Ahead and Hour-Ahead Markets). Existing Contracts are assured the right to schedule their transactions, up to the contracted capacity, without

additional costs. In contrast to Usage Charges, Zonal MLCC costs are charges incurred to maintain the real-time reliability of the transmission grid, in particular at the Inter-Zonal Interfaces. If the ISO lacks adequate resources to resolve Inter-Zonal Congestion in real-time, the Existing Contract schedule may be subject to curtailment according to the terms of the contract, *see* ISO Tariff Dispatch Protocol § 8.3; Schedules and Bids Protocol § 3.3 (Item by Reference 1, Sheets 477, 549-51). If the Inter-Zonal Interface fails in real time, all users suffer, including those users with Existing Contract rights. Consequently, Must-Offer Waiver Denials provide a very real benefit to the Existing Rightsholders that is not provided by the Existing Contracts.

2. The Initial Decision Is Consistent with Commission Precedent Regarding the Imposition of Reliability and Redispatch Costs on ETCs.

SWP contends that the Initial Decision disregards Commission precedent regarding the imposition of reliability and redispatch costs on ETCs. SWP quotes Opinion No. 459 to the effect that a "proposal to add an allocation of Cal ISO [reliability service] charges to the unadjusted rates of the ETC customer is not just and reasonable because it results in a double recovery." SWP Br. at 36.[6] SWP then states that the Commission reads the protection of ETCs broadly, quoting *Midwest Independent Transmission Operator Corporation, Inc.:*

> Transmission usage charges, FTR debits and credits, and uplift costs are essentially redispatch costs, substantially

[6] *Citing Pacific Gas & Elec. Co.*, Opinion No. 459, 100 FERC ¶ 61,160 at P 20, *reh'g denied*, Opinion No. 459-A, 101 FERC ¶ 61,139 (2002), *reh'g denied*, Opinion No. 459-B, 102 FERC ¶ 61,009 (2003).

> similar to the redispatch costs associated with the reliability services at issue in Opinion Nos. 459 and 459-A.

*Id (*emphasis added).[7]

In contrast, however, in *Pacific Gas and Electric Company*, Opinion No. 477, 109 FERC 61,093 (2004), PP 54-65, the Commission ruled that PG&E's Scheduling Coordinator Services are new services, the costs of which PG&E can pass through to Existing Contract customers. The question, therefore, is whether the services provided through Zonal must offer waiver denials are the same protection against Congestion costs that are provided under Existing Contracts. They are not.

Under their Existing Contracts, Existing Rightsholders have the right to schedule on the capacity reserved for them. If others are competing for that capacity, there is no additional charge to preserve that capacity. Hence, they are exempt from ISO Usage Charges. Moreover, depending on the specific contract, they may have priority in the case of a derating of a line in real time. This right is preserved under the ISO Tariff with no additional charges. *See* ISO Tariff Dispatch Protocol § 8.3; Schedules and Bids Protocol § 3.3 (Item by Reference 1, Sheets 477, 549-51).

The Existing Contracts do not, however, provide that the ISO will ensure that there will be units available online to ensure that adequate capacity will remain on the Inter-Zonal Interface to ensure that the Existing Contract schedules can be fulfilled. Indeed, the contracts could not, because the ISO did not exist. The situation is not unlike

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[7] *Citing* 108 FERC ¶ 61,236 at P 162 (2004), *on reh'g* 111 FERC ¶ 61,042, *on reh'g* 112 FERC ¶ 61,311 (2005).

that in PG&E's Scheduling Coordinator Services Tariff, where the Existing Rightsholders contended that they could not be charged for PG&E's additional Ancillary Services costs attributable to their Schedules because they self-provided Ancillary Services under their schedules. The Commission responded:

> Unlike the reliability service costs that the Commission concluded were inherently included in contracts that were executed prior to restructuring, the SC costs at issue here, were not included in any of the [Control Area Agreements]. The Ancillary Services requirements of the ISO postdate the [Control Area Agreements] which were negotiated before the ISO came into existence, and therefore the [Control Area Agreements] could not have anticipated the difference between the ISO's requirements for Ancillary Services and those specified in the [Control Area Agreements]. Therefore, it is wrong to conclude that merely because customers self-provided "ancillary services" under their contracts, those contracts inherently satisfied the "Ancillary Services" requirements of the ISO as part of their firm service.

109 FERC ¶ 61,093 at P 66 (quoting the Initial Decision).[8] So too, the reliability benefits of the protection against real-time Inter-Zonal Congestion provided by the Must Offer generation is not the same scheduling priority provided by Existing Contracts or even the reliability benefits the utilities had previous provided through what are currently Reliability Must Run units, and parties to Existing Contracts need not be excused from an allocation of the costs of those benefits.

D. Considerations of Demand Response Do Not Undermine the Validity of the

[8] The Commission may wish to take official notice of the fact that PG&E has proposed that all MLCC be included in PG&E's Scheduling Coordinator Services Tariff, although an Initial Decision has not been issued on that issue. *See* Attachment 3 to Testimony of Peter Bray, filed May 18, 2004, in Docket No. ER00-585.

Initial Decision Regarding Time-Sensitive Rates. (ID Issue 3; JSCI Issues I.A, I.E.2; SWP Exceptions III.A, III.B, IV.D)

SWP contends that by focusing on benefits received, and failing to implement time-sensitive rates, the Initial Decision "thwart[s] demand response in contravention of Federal law and Commission policy." SWP Br. at 40. To the contrary, this proceeding has nothing to do with demand response. The ISO has not contended, and does not contend, that time-sensitive rates would be unjust and reasonable. The ISO has simply contended that the rates as proposed in Attachment E, and as approved in the Initial Decision, are also just and reasonable. The implementation of time-sensitive rates will not affect demand response; the only effect will be to complicate ISO settlements and to reduce SWP's costs.

The ISO does not disagree that it is the national policy and Commission policy to *encourage* demand response. *See, e.g.,* SWP Br. at 53, citing Energy Policy Act of 2005, Pub. L. No. 109-58, § 109-58. The encouragement of demand response does not mean, however, that the Commission must blindly institute time-sensitive rates at every possible opportunity. The Commission has firmly rejected arguments that Court and Commission precedent dictate "that a rate methodology is not reasonable if it fails to differentiate cost-causation and thus pricing between on-peak and off-peak users." *California Indep. System Oper. Corp.*, 111 FERC ¶ 61,337 at P 85 (2005). The Commission also considered it relevant to consider how many parties would benefit from the use of time-sensitive rates. *Id*. at P 83. In this proceeding, the only party seeking time-of-use rates, and apparently the only party that would benefit therefrom (as discussed below), is SWP.

Nonetheless, if time-sensitive rates might serve to promote demand response in this proceeding, there might still be reason for the Commission to impose them. They would not.

First, the California Public Utilities Commission has already instituted a Resource Adequacy requirement that will commence in June 2006,[9] and, under Commission orders, the Must-Offer Obligation will cease no later than the implementation of MRTU in early 2007 and likely as early as the beginning of the Resource Adequacy Requirement. *California Ind. System Oper. Corp.*, 108 FERC ¶ 61,254 at P 10 (2004). As of the date of this Brief, therefore, the time horizon of future MLCC allocation is six months to a year– and it will be much shorter by the time of a Commission decision.

Second, the record does not provide evidence that during the short time horizon for the costs at issue, Demand could respond. With the exception of SWP and a few like-situated entities, however, must-offer charges are not assessed to end-use loads that can respond to such price signals. Time-of-use must-offer charges would have to be reflected in time-of-use retail rates in order to provide any sort of incentive to Load shifting and SWP has presented no evidence that the metering requisite equipment is in place or that the value of time-of-use MLCC charges would constitute a sufficient portion of rates to render the ISO's proposal unjust and unreasonable. As to SWP, it already operates its pumps off-peak due to time of use Energy savings. Tr. 1079:10 – 1081:11. Although

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[9] *See* Opinion on Resource Adequacy Requirements, Decision 05-10-042, California Public Utilities Commission, October 27, 2005.

SWP cites its consultant for the proposition that it could provide greater Demand response, his testimony is theoretical. It provides no evidence of SWP's ability to shift additional pump load. Of course, SWP could build new reservoirs, but no party will make infrastructure investments based on the outcome of this proceeding. Rather, the result of the imposition of time-sensitive rates will be a significant retroactive reallocation of costs away from SWP, which has already been operating off-peak for reasons unrelated to the Must Offer charges. *See, e.g.,* Tr. 1082.

E. The Initial Decision Properly Rejected an Exemption for Pump Load; SWP's Arguments that Its Pumps Load Receive No Protection from Curtailment Are Unsupported. (ID Issue 3, JSCI Issue I.H; SWP Exception IV)

SWP asserts that it does not obtain the benefits of must offer generation – the protection against the curtailment of firm load – because "SWP pump loads can and have been dropped in order to protect other, firm, loads," SWP Br. at 70, and because the ISO treats SWP pump loads as interruptible, *see generally* SWP Br. at 70-74. These contentions are, quite simply, factually unsustainable.

The citations to Mr. McIntosh's testimony in SWP's Brief involve SWP bids of its pump loads into the markets or requests by the ISO that SWP voluntarily drop its Load. Tr. 273:13 – 274:3, 281:23 – 282:1. SWP's claims that the ISO regularly drops SWP's load are belied by the fact that in that very testimony, Mr. McIntosh discusses the fact that the SWP refused to drop its load when the ISO requested assistance in addressing line overloads "south of Magunden." Tr. 294:3-23, 396:19 – 397:8.

The actual facts are these. (1) The ISO has no authority to direct that SWP pump

loads be involuntarily interrupted or curtailed. Tr. 280:3-6. (2) The only circumstance in which the ISO will direct that SWP pump loads will be interrupted or curtailed is if SWP voluntarily bids those loads into the ISO's markets or pursuant to a Remedial Action Scheme in an agreement with the ISO or a Participating TO. *Id.* See Exh. SWP-22L at 3, cited at SWP Br. at 56. (3) The ISO has not directed that SWP pump loads be involuntarily interrupted or curtailed since the beginning of the must-offer obligation. Tr at 396:15-18. (4) SWP's pumps are set to trip at a higher frequency in the event of a frequency disturbance. This is an automatic action, not one undertaken by the ISO. Tr at 397:9 - 398:15.

In part, SWP argues that because ISO personnel, including some at the managerial level, would prefer the SWP Load be interruptible, SWP Br. at 70-71, and because SCE's transmission plan mistakenly treated certain SWP Load as interruptible, id. at 72-73, it must be interruptible. There is no law or logic behind this argument. If the ISO's opinions or desires sufficed to make SWP's pump Loads interruptible, the ISO would not have asked SWP to curtail its pump Loads to address line loadings south of Magunden, only to be refused. It would have simply interrupted the Loads. Similarly, the ISO's delay in revising its procedure to reflect the termination of SWP's contract with SCE, SWP Br. at 71-72, proves nothing. Under the procedure, the ISO would have notified SWP to take action under the contract. Inasmuch as SWP was aware of the contract termination, it would have informed the ISO of the lack of authority.

SWP asserts that its transmission is interruptible for the purposes of reduced cost responsibility because of the ISO's "right to interrupt" its pump loads. SWP Br. at 73. It

cites four factors as evidence of the ISO's right to interrupt. The first is its Participating Load activities. *Id.* SWP's Participating Load activities are its participating bids in the ISO's Energy markets. In such circumstances, SWP is acting the same as a Merchant Generator; its demand bids will be treated like Generation bids, and SWP will be compensated at the Market Clearing Price if its bids are selected. Tr. at 395:6 – 396:14. SWP is not signing up for interruptible transmission service, allowing the ISO to interrupt its Loads whenever the ISO feels it appropriate. It is telling the ISO to treat its Loads like Energy. SWP evaluates the additional cost of its pumping at another time, places a market value on being interrupted in a particular hour, and bids their Loads in at that value. The ISO can interrupt SWP's Loads if, and only if, the market value of Energy in a trading period has reached the market value that SWP has placed on its Load.

SWP next points to its underfrequency load shedding setting. As noted above, this is an automatic action, not one undertaken by the ISO. It is not an ISO "right to interrupt" SWP's load. It only occurs if the ISO's efforts to prevent frequency collapse – through, e.g., the use of must-offer generation and, if necessary, directed load interruption – fail. Tr. at 398:15-23. The fact the SWP's pump loads will trip automatically in the case of a frequency collapse is, in fact, proof that that those Loads benefit from the ISO's use of must-offer Generation to avoid a frequency collapse. It is also worth noting that SWP's pump loads trip after other pump loads in the state. Tr. 397:19-20.

Third, SWP mentions its participation in the Remedial Action Schemes or RAS. SWP Br. at 73-74. The only evidence that SWP discusses is a data response in SWP-22L in which the ISO discusses an RAS for a double line outage on Path 15, and notes that

Must-Offer Generation is only committed for single contingencies. Thus, SWP receives the same benefits as every other entity as a protection against single contingencies. Moreover, SWP is compensated for such participation in RAS in the event of a double contingency. *See Pacific Gas & Electric Co.*, 109 FERC ¶ 61,255 at P 65 (2004) (discussing SWP's compensation for Path 15 RAS). SWP has not explained why its paid participation in a RAS for a double contingency should excuse it from sharing the cost for protection from single contingencies.

As its fourth contention, SWP relies upon the ISO's "confidential procedures, requests or orders to curtail 'load.'" SWP Br. At 73-74. The ISO has not, however, curtailed SWP pump load other than through a market bid or an agreement since the beginning of the Must-Offer operations, Tr. at 396:15-18, and SWP has identified no existing agreements, other than the RAS, that would allow such curtailment. As for RAS schemes, as noted above, Must-Offer is only intended for single contingencies. The ISO's statement that it does not procure Must-Offer Generation "to protect SWP load (which the ISO would drop [to prevent overloads and/or to maintain voltage levels) in anticipation of contingencies on such Paths as 15, 26 and 66," cited in support of this argument (SWP-22L at 12, SWP Br. at 74) is entirely unremarkable. The ISO does not procure Must-Offer Generation to protect against accepting Demand bids in its markets. The purpose of the Must-Offer requirement is to ensure that there are adequate bids in the ISO's markets, *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services, et al.*, 95 FERC ¶ 61,115 at 61,354-56 (2001), and Demand bids are treated the same as Generation bids. Tr. at 395:6 – 396:14.

The remainder of SWP's "evidence" that its load is treated as interruptible is twofold. First is the understandable belief of ISO personnel that interrupting pumps, and therefore moving water at a later time, is less important than interrupting firm retail load, where it is possible to distinguish the dispensable from the indispensable, such as traffic lights and in-home medical equipment. SWP Br. at 74. Although SWP omits it, for example, the Willis deposition that it cites goes on to discuss ISO procedures are being corrected to ensure that SWP pumps are not curtailed before firm retail Load. SWP-28B at 34.

Second SWP asserts that the ISO and SCE treat SWP pump load as interruptible in transmission planning. Here it merely repeats its assertions about the "uniform view" of ISO personnel and cites a statement about its Edmunston pumps in SCE's long term transmission plan – a statement SCE admitted was a mistake. SWP Br. at 74; Exh. SWP-51 at 39; Tr. 1220:1-5 (Hansen). This does not constitute a demonstration of interruptible transmission service.

F. The Initial Decision Properly Endorsed the Attachment E Allocation of Tier I System MLCC to Net Negative Uninstructed Deviations. (ID Issue 3; JSCI II.K; Powerex Exceptions 1-3)

Powerex contends that the Initial Decision erred in concluding that the Attachment E Allocation of Tier I System MLCC to Net Negative Uninstructed Deviations is just and reasonable and in rejecting Powerex's proposal to allocate system MLCC according to deviations from Day-Ahead Schedules. Powerex Br. At 6-7, 11-12. The ISO does not contend, and has not contended, the Powerex's proposal would be unjust and unreasonable. Rather, the ISO contends that the Initial Decision properly concluded that

the Attachment E criteria is just and reasonable. The ISO incurs System MLCC costs in order to keep Supply and Demand in balance in the Control Area. Supply and Demand become out of balance when forward schedules do not match up with (i.e., they deviate from) what appears in real time. Although the ISO may make must offer waiver denial decisions based on Day-Ahead schedules (among other factors, as the Initial Decision noted, ID at P 114), it makes those decisions in order to have capacity available to respond to uninstructed deviations. Allocating the cost to Net Negative Uninstructed Deviations is thus among the just and reasonable allocation. At the hearing, however, ISO witness Jim McIntosh indicated that implementing the alternative Powerex proposal would expend ISO resources in terms of software development, and added that "any software work we do now, has the potential to impact the delivery of MRTU." Tr. 542:9-13. For this reason, the ISO believes the implementation problems of the Powerex proposal recommend Attachment E as the preferable alternative.

In its Brief on Exceptions, however, Powerex cites a report of the ISO Department of Market Monitoring to the effect that the Attachment E allocation is inconsistent with cost causation. Powerex Br. at 5, citing Attachment A to Powerex Brief. Separately, Powerex has asked the Commission to reopen the record to consider that report. The Commission Trial Staff has filed an Answer opposing Powerex's motion, which the ISO has supported. Even if the Commission accepts the evidence into the record, however, it provides no reason to reverse the Initial Decision.

The ISO Department of Market Monitoring ("DMM") operates independently of ISO Management. Its opinion regarding the consistency of the Attachment E allocation

with cost causation is not the opinion of ISO Management, and is simply another opinion for the Commission's consideration. It is highly significant that, in a contemporaneous document submitted with Staff's answer, the DMM recommended *against* attempting to modify the Attachment E allocation as part of the Amendment No. 60 proceeding. (Attachment A to Answer of Commission Trial Staff to Motion of Powerex Corporation to Reopen the Record and Motion of Commission Trial Staff to Strike Portions of Powerex Corporation's Brief on Exceptions, "Assessment of Day-Ahead Scheduling Practices," (August 29, 2005) at 9-10, 13). The Commission should not take contrary action.

G. The Initial Decision Properly Rejected Southern Cities Proposal for the Self-provision of Inertia. (ID Issue 3; JSCI Issue I.I; SOC Exception 2)

Southern Cities believes that the Initial Decision erred by not adopting their proposal for the self-provision of inertia. SOC Br. At 2, 12-13. As an initial matter, the ISO notes that the Presiding Judge had no obligation to consider this proposal. Having concluded that the ISO's proposed allocation of the local, zonal, and system categories (as opposed to the assignment of costs to the categories) was just, reasonable, and nondiscriminatory, I.D. at 62, the Presiding Judge was not required to examine proposals that did not fit within that paradigm. Nonetheless, the Initial Decision proceeded to conduct a reasoned analysis of the Initial Decision. Southern Cities criticizes the analysis in a number of areas, including the assertion that four of the Initial Decision's bases for rejecting the proposal rely upon factual assertions that have been refuted in the record.

First, Southern Cities asserts that the Initial Decision proceeded from a

misunderstanding when it concluded that "[Load Serving Entities ('LSEs")] do not provide ISO with the real-time power flow information required to determine LSE-specific load-ratio shares of intertia for SCIT." SOC Br. at 17. As discussed below, it is Southern Cities, not the Presiding Judge, that misunderstands the problem. Southern Cities is correct that Mr. McIntosh's testimony, on which the Initial Decision relies, was based on Mr. Tang's original, rather than his revised, proposal. *See* SOC Br. at 17, n. 12. Mr. Tang's revised proposal, however, does not resolve the problem.

Mr. Tang revised his proposal such that the ISO would bill LSEs on an ex post basis according to "their percentage share of the SCIT-requirement." According to Southern Cities, the ISO would thus no longer need to calculate load-share ratios in real-time. SOC Br. at 18. The problem with Mr. Tang's proposal, however, was not the time of the calculation, but the nature of the data. The data that the ISO would need to calculate load-share ratios of inertia would be data on power flows (which occur in real time) regardless of whether the calculation was done in real time or weeks later. Load Serving Entities do not provide the ISO with that information. Exh. ISO-21 at 11; Tr. at 419, 422.

Second, Southern Cities notes the Initial Decision's conclusion that the "ISO cannot determine SCIT-related inertia requirements – which are zonal – until after it has addressed local reliability requirements, which would be too late to accommodate self-provision of inertia for SCIT." SOC Br. at 18. Although Southern Cities contends that this conclusion relies upon discredited testimony, that contention is based on a fundamental misunderstanding. Pressed by Southern Cities counsel, ISO Witness

McIntosh acknowledged that the ISO knows the total amount of necessary inertia in SP-15, although not the unit commitments, by 10:00 a.m. SOC Br. at 19 Contrary to Southern Cities' argument, however, that is insufficient information to allow LSEs to announce self-provision of inertia to the ISO. As Southern Cities acknowledges, *id.*, the ISO denies waivers based on the SCIT nomogram after it fulfills local and other zonal needs. Units that fulfill the local and other zonal needs may reduce the SCIT requirement. Thus, although the ISO may know its *total* inertia requirement in SP-15 by 10:00 a.m., it will not know its *net* inertia requirement until after it has determined all other unit commitments. The final commitment of units usually occurs around 11:00 a.m., just before the final Day Ahead Market is run. Tr. at 401. Thus, as the Initial Decision quite properly found, by the time the ISO knows its net SCIT requirements, it is too late to implement a self-provision process that would necessarily require revisions to Day-Ahead schedules.

Third, Southern Cities challenges the Initial Decision's reliance on Staff witness Gross's testimony to conclude that it proposal would "require resource/time-intensive modifications to ISO operating and settlement procedures and software." SOC Br. at 19. Despite the statement of ISO witness McIntosh the implementation would take months, Southern Cities offers instead the testimony of its own witness that implementation would be simple. Southern Cities ignores the fact that the Initial Decision is also support by the testimony of ISO settlements personnel. Contrary to the optimism of Mr. Tang, Ms. Bodine, a key ISO employee involved in the ISO's settlement processes, has testified that "creating an entirely new process to address, essentially, one constraint would be

burdensome and counter productive in the current environment where the ISO's settlements systems are being overhauled [as part of MRTU]." Exh. ISO-19 at 22. Moreover, Mr. McIntosh explained that the ISO personnel needed to develop the Southern Cities' proposal are the same individuals currently involved in the MRTU process, which would be "a detriment to getting that program here on time." Tr. 499:7-11.

In addition, while, as described above, the benefits of such a new process would inure to a few Market Participants, Ms. Bodine notes that the costs would be spread across all rate payers. Exh. ISO-19 at 22. Similarly, any delay in MRTU that resulted from the ISO having to devote resources to develop this proposal would constitute a delay in benefits to the entire market. Tr. 1459:20-24 (Tang).

Finally, Southern Cities refers to the Initial Decision's citation of Staff testimony that the SCIT nomogram will be retired, eliminating the need for the commitment generation inertia, which Southern Cities states was contradicted by evidence that the ISO will continue to procure inertia. SOC Br. at 20. The Initial Decision, however, only cited the testimony for the proposition that the SCIT nomogram would be retired—an uncontradicted fact—as a reason that the resources necessary to institute self-provision were disproportionate to the benefits.

Despite Southern Cities' arguments, the Initial Decision's reasons for rejecting self-provision are on solid ground. The Commission should affirm them.

H. The Amendment No. 60 Methodology Should Not Apply to Start Up and Emissions Costs. (ID Issue 14, JSCI Issue I.L; Staff Exception 3)

The Initial Decision concluded that the issue of whether the Amendment No. 60 Methodology should apply to Start Up and Emissions Costs is outside the scope of the proceeding. Both PG&E and Staff take exception to the conclusion. PG&E contends that it raised this issue in its complaint, and that the Commission has made clear that MLCC should be allocated consistently with Start Up and Emissions costs. PG&E Br. at 7, 11. Staff contends that regardless of whether the Commission set the issue for hearing, Commission precedent requires that Start Up and Emissions Costs be allocated consistently with MLCC. Staff Br. at 16-18. Neither exception in the proceeding justifies applying the Amendment No. 60 methodology to Start Up and Emissions Costs, nor does the evidence.

Even if one assumes that PG&E raised the issue in its complaint and the Commission set the issue for hearing, PG&E still bears the burden of proving that the existing methodology for allocating Start Up and Emissions costs is just and reasonable. Stipulation No. 3, under which the ISO agreed that the pre-Amendment No. 60 methodology was unjust and unreasonable, only applied to MLCC. The only argument that PG&E or Staff makes regarding Start Up and Emissions costs is that the Commission has previous required that MLCC be allocated consistently with those costs.

The Initial Decision properly rejected that argument. The Commission first determined the allocation of Start Up and Emissions Costs. 95 FERC ¶ 61,418 at 62,562 (2001). It later decided that MLCC should be allocated in the same manner. 97 FERC 61,293 at 62, 363. The ISO has not proposed a different allocation for MLCC. If the Commission approves the ISO's proposal, it has effectively reversed its previous

direction that the MLCC be charged consistently with Start Up and Emissions costs. Its approval of the MLCC allocation has no effect on the other charges.

The ISO notes, however, that should the Commission determine that revision of the method by which Emissions and Start-Up Costs are allocated is an appropriate subject matter for this proceeding, the ISO does not oppose the alternative means of allocating Start-Up Costs advocated by PG&E (Exh. PGE-4 at 5-6), SWP (Exh. SWP-1 at 40-41), and the Commission Staff (Ex. S-18 at 26-27), as they do not present any significant implementation difficulties for the ISO. Exh. ISO-19 at 19.

With regard to the allocation of Emissions Costs, however, the situation is not so simple. It is not possible for the ISO to separate out the Emissions Costs properly associated with must offer wavier denials from those related to any other ISO Dispatch. Exh. ISO-19 at 20.[10] Ms. Bodine further explained on the stand that although it might be possible for Scheduling Coordinators to submit Emissions Costs broken out between must offer waiver denial costs and other Emissions Costs, there would be no way for the ISO to verify such figures. Tr. 756:14 – 757:12. That being the case, although the Emissions Costs allocation alternatives (i.e., the same mechanisms suggested by PG&E, SWP, and the Commission Staff with regard to Start-Up Costs) are not complicated (Exh.

[10] Contrary to Staff's assertion, the ISO's payment of Emissions Costs is not contrary to the ISO Tariff. Emissions Costs are paid to Must Offer Generators, which are those subject to the must offer obligation, that are dispatched by the ISO and incur such costs. Whether the Must Offer Generator has sought and been denied a waiver is irrelevant. *See* [95 FERC 61,418 at 62,560], ISO Tariff §§ 2.5.23.3.6.6, 2.5.23.3.6.5, Item by reference 1, sheet 110G.

ISO-19 at 19), the ISO simply cannot determine to which Emissions Costs these allocation methodologies should be applied. For this reason, the ISO believes Emissions Costs associated with must offer waiver denials should continue to be allocated in the same manner as all other Emissions Costs.

I. The ISO's Stipulation Established that the Allocation of MLCC Costs Was Unjust and Unreasonable from July 17, 2004, to September 30, 2004. (ID Issue 20; JSCI EL04-104 II; SCE Exceptions 9-10)

SCE contends that, because the Stipulation No. 3 was not signed by all parties, the Initial Decision erred in concluding that Stipulation No. 3 established that the pre-Amendment No. 60 methodology was not just and reasonable as of July 17, 2004. SCE Br. at 14. SCE misunderstands the effect of the stipulation. Under Section 205, of the Federal Power Act, the ISO establishes its rates, unless the Commission concludes they are unjust and unreasonable, in which case the Commission may establish them under Section 206. No other party may establish the ISO's rates. Also under Section 205 of the Federal Power Act, it is the ISO's responsibility to establish that its rates are just and reasonable. Although a party challenging those rates has the burden of establishing a prima facie case that the rates are unjust and unreasonable, ultimately the ISO must defend its rates.

It only follows that a stipulation by the ISO in a complaint proceeding that its rates are unjust and unreasonable is determinative. If the ISO made such an admission in its Answer to the Complaint, the issue would not have been set for hearing. There is no reason that the admission should have a different effect through a stipulation.

SCE contends that flaws in the data available to implement Amendment No. 60

prior to October 1, 2004, preclude its adaptation as a just and reasonable methodology and thus preclude a finding that the pre-Amendment No. 60 methodology is unjust and unreasonable. SCE Br. at 14-15. SCE confuses the Commission's responsibilities when evaluating a public utility's rates with its responsibilities when selecting an alternative rate following a finding that a rate is unjust and unreasonable. Whether the pre-Amendment No. 60 methodology was just and reasonable after July 17, 2004, is independent of whether the Amendment No. 60 methodology was just and reasonable between July 17, 2004, and September 30, 2004. The first was established by stipulation. With regard to the latter, there is no evidence of continuing data problems that would interfere with the implementation of the methodology directed by the Initial Decision.[11] The only remaining data problems, instance where waiver denials were attributed to more than one category, were specifically addressed by the Initial Decision. ID at P 131.

J. The Net Incremental Cost Methodology for Local MLCC Cannot Be Implemented for the Period Prior to October 1, 2004. The Methodology Described in Exh. ISO-22, pp. 40-42 Could Be Implemented If the Commission So Decides. (ID Issue 21; JSCI Issue EL04-103 II; Exception

[11] SCE includes three citations for its assertion of flawed data. SCE Br. at 15 n. 41. The first is Staff's statement of concern, in its Initial Brief, based on the *historical problems experienced*, about the need for transparency in applying the alternative methodology for calculation of net incremental local costs discussed in section IV.J *infra*. Staff made no statements about current flaws. The Initial Decision addressed Staff's concerns at P 122. The second is simply a conclusory statement from the Initial Brief of Southern Cities. The only testimony cited by Southern Cities concludes that the data is sufficient to calculate refunds. The last is a historical description in SWP's Initial Brief to problems in data collection. SWP's own witness testified that those problems had been resolved sufficiently except with regard to dual categorization and implementation of net incremental local costs prior to October 1, 2005. Exh. SWP-18 at 35.

SCE 11)

SCE contends that the Initial Decision erred by concluding that the net incremental methodology for local MLCC should not be used to calculate refunds for the period from July 17, 2004, through September 30, 2004. SCE Br. at 3, 16-17. The evidence is unambiguous, however, that the software for such calculations was not in place until October 1, 2004. Exh. ISO-20 at 38-39. The ISO did, however, offer an alternative methodology that would approximate the application of the net incremental methodology during that period. *See* Exh. ISO-22 at 40-42. The ISO agrees with PG&E, *see* PG&E Exception 5, that the Initial Decision is unclear regarding whether the alternative methodology is to be applied. *Compare* ID at P 122 *with* ID at P 141. This matter requires clarification.

VI. CONCLUSION

WHEREFORE, the Commission should reject the Exceptions Opposed for the reasons discussed above.

Respectfully Submitted,

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Date: December 20, 2005

Certificate of Service

I hereby certify that I have this day served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010). Dated this 20th day of December in the year 2005 at Folsom in the State of California.

/s/ *Geeta Tholan*
Geeta O. Tholan