UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket No. ER98-3760-000**
California Independent System Operator Corporation	)	**Docket Nos. EC96-19-000 and ER96-1663-000**
		[Not Consolidated]

INITIAL BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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In accordance with the Commission's orders of April 28, 1999, 87 FERC ¶ 61,102 (the "April 1999 Order"), and January 20, 2000, 90 FERC ¶ 61,051 (2000), the California Independent System Operator Corporation ("CAISO") submits this Initial Brief addressing three of the unresolved issues in the above-captioned proceedings. The CAISO first raised these issues in its December 1, 1997 Requests for Rehearing, Motion for Stay and Motions for Clarification of the Commission's October 30, 1997 order, Pacific Gas and Electric Company, et al., 81 FERC ¶ 61,122 (the "October 1997 Order"). These issues concern: (1) the

liability standard under the CAISO Tariff (Issue No. 676 in the Joint Statement of Issues filed on January 4, 2000) , (2) the scope of the Metered Subsystem ("MSS") proposal (Issue No. 677), and (3) the grandfathering of End-Use Meters of ISO Metered Entities (Issue No. 675).[1] As discussed herein, the Commission should permit the CAISO to include in its tariff reasonable and appropriate limitations on its liability; limit the MSS concept to existing Governmental Entities[2] with Existing Contracts; and confirm that the CAISO retains the authority under its tariff to require upgrading of End-Use Meters of ISO Metered Entities where necessary to maintain system reliability or enhance operation of the CAISO markets.

I. Background

On March 31, 1997, the CAISO filed its Phase II proposal to restructure the California electric utility industry. In its October 1997 Order, the Commission conditionally authorized limited operation of the CAISO. On December 17, 1997, the Commission conditionally accepted certain of the CAISO's proposed tariff changes and pro forma agreements. Pacific Gas and Electric Company, et al., 81 FERC ¶ 61,320 (1997). The Commission also noted that the CAISO would be making a compliance filing sixty days from the commencement of operations and stated that interested parties would be permitted to pursue at that time issues not

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

[2] Governmental Entities include municipal utilities, irrigation districts, state agencies, federal agencies, and joint power authorities.

previously resolved by the Commission. Id. at 62,476. The CAISO made its Compliance Filing on June 1, 1998. On July 15, 1998, the CAISO submitted amendments to the CAISO Tariff in Docket No. ER98-3760-000 to correct and clarify a variety of non-substantive matters (the "Clarification Filing"). As part of this Clarification Filing, the CAISO submitted a procedural proposal for addressing issues previously raised in Docket Nos. EC96-19 and ER96-1663, but not resolved in prior Commission orders in those proceedings (the "WEPEX" proceedings).

In its September 11, 1998 Order in Docket No. ER98-3760-000, the Commission directed the CAISO and the other participants in the WEPEX proceedings to develop a comprehensive list of the issues that remained active and in dispute. California Independent System Operator Corporation, 84 FERC ¶ 61,217, 62,048 (1998). The Commission further directed its Trial Staff to participate in and facilitate negotiations involving the CAISO and participants to resolve as many of these outstanding issues as possible through settlement. Id. Lastly, the Commission directed the CAISO and participants to submit a report on the results of these negotiations and indicated that this report should include a list of the outstanding issues that had been resolved through settlement and a list of those issues that remained for Commission resolution. Id.

On March 11, 1999, the CAISO filed its Report on Outstanding Issues (the "March 1999 Report"). In its April 1999 Order, the Commission accepted the March 1999 Report for filing, established procedures to incorporate issues that had been resolved by the parties into an Offer of Settlement, and specified

further procedures to address issues that remained in dispute. California Independent System Operator Corporation, 87 FERC ¶ 61,102. The Commission required the CAISO to file an updated unresolved issues report and a Joint Statement of Issues identifying the issues to be briefed to the Commission two weeks after the initial comments on the Offer of Settlement were to be filed.

On December 1, 1999, the CAISO filed an Offer of Settlement. On January 4, 2000, the CAISO filed an Updated Unresolved Issues Report (the "January 2000 Report") which updated the matrices identifying the disposition of the approximately 680 unresolved issues identified in the March 1999 Report to reflect subsequent negotiations, the Offer of Settlement, and comments on the Offer of Settlement. In addition, the January 2000 Report provided further information required by the Commission to permit it to track the unresolved issues against their originating dockets. A separate Joint Statement of Issues was also filed on January 4, 2000.

In accordance with the April 1999 Order, the CAISO hereby files this Initial Brief addressing three of the CAISO's outstanding issues. The CAISO reiterates its request for rehearing on the issue of liability, continues to seek clarification on the scope of MSSs, and requests confirmation of its right to require upgrading of End-Use Meters of ISO Metered Entities pursuant to Section 10.2.2 of the CAISO Tariff.

II. Executive Summary

The CAISO is filing this Initial Brief with respect to three issues:

Issue No. 676 — Whether the Commission erred in requiring modification of the liability provisions in Sections 14.1 and 14.2 of the CAISO Tariff?

In the October 1997 Order, the Commission determined that it was appropriate for the CAISO to be protected from liability under an ordinary negligence standard. In recent decisions involving the New York ISO, however, the Commission has recognized that ISOs perform activities associated with administering markets and performing control area services that go beyond the requirements of transmission providers under the Commission's pro forma open access tariff and that an ISO could protect itself under a gross negligence standard of liability for these services. At a minimum, the Commission should grant the CAISO the same protections accorded the New York ISO. Moreover, even with respect to other services, the limitations proposed in Sections 14.1 and 14.2 of the CAISO Tariff are appropriate under longstanding California utility law and historical Commission treatment of consequential damages. The Commission should apply the higher standard of liability to all activities under the CAISO Tariff. The CAISO also recognizes that the issue of liability under the Commission's open access tariff is currently pending before the United States Court of Appeals. To the extent that the Court determines that it was inappropriate for the Commission to restrict transmission providers under the pro forma tariff to a negligence standard of liability, the Commission should similarly reconsider its order subjecting the CAISO to liability for ordinary negligence.

Issue No. 677 Whether the MSS concept under the CAISO Tariff should be limited so that it would only be used as a vehicle to respect existing operational capabilities for Existing Rights holders?

The MSS proposal included in the March 31, 1997 CAISO Tariff filing was intended as a potential vehicle to respect and accommodate existing operational capabilities for Existing Rights holders. By qualifying as an MSS, an existing utility system could continue to utilize its Existing Rights and avoid more substantial changes in its integrated utility operations as a result of the restructuring of the investor owned California utilities. The CAISO has been working to develop this mechanism with other interested parties over the last year. The Commission should clarify that the CAISO is not required to create special arrangements for operators or Scheduling Coordinators that seek through the acquisition of physical assets or associated contract rights to create new MSSs or that desire to submit bids from geographically disparate resources that are connected by portions of the ISO Controlled Grid.

Issue No. 675 Whether End-Use Meters of ISO Metered Entities should all be grandfathered or whether there should be a case-by-case evaluation?

In the October 1997 Order, the Commission required the CAISO to clarify that End-Use Meters of ISO Metered Entities would be deemed to be certified as in compliance with CAISO standards. The CAISO seeks confirmation that the Commission did not intend to revoke the CAISO's ability pursuant to another provision of the CAISO Tariff, Section 10.2.2, to require upgrades to meters of ISO Metered Entities where necessary to maintain system reliability or enhance

operation of the CAISO markets. The CAISO recognizes that the question of whether to require meter upgrades for a class of End-Use Meters is one that needs to be discussed with stakeholders. For example, the issue of metering and CAISO data requirements may be a significant factor in the upcoming stakeholder discussions on reforming the CAISO's Intra-Zonal Congestion management protocols. Moreover, the CAISO has experienced examples of high Unaccounted for Energy calculations, due in part to meter error. This issue has been discussed and is still under review as part of the CAISO's Settlement Improvement Team. Only if the CAISO determined, as a result of the stakeholder process, that it would be necessary to propose that certain categories of End-Use Meters of ISO Metered Entities warranted upgrading, would it seek to require such improvements.

III. Argument

A. Whether the Commission erred in requiring modification of the liability provisions in Sections 14.1 and 14.2 of the CAISO Tariff? [Issue No. 676, Docket Nos. EC96-19-009 and ER96-1663-010]

As proposed, the CAISO Tariff included limitations on the CAISO's liabilities for damages and consequential losses. As proposed, Sections 14.1 and 14.2 of the CAISO Tariff read as follows:

> **14.1 Liability for Damages.**
> Except as provided in Section 13.3.14, the ISO shall not be liable in damages to any Market Participant for any losses, damages, claims, liability, costs or expenses (including legal expenses) arising from the performance or non-performance of its obligations under this ISO Tariff, including but not limited to any adjustments made by the ISO in Inter-Scheduling Coordinator Trades, except to the extent that its breach of the provisions of this Tariff results directly in physical damage to property owned, operated by or under the Operational Control of any Market Participant or in the death or injury of any person.
>
> **14.2 Exclusion of Certain Types of Loss.**
> The ISO shall not be liable to any Market Participant under any circumstances for any consequential or indirect financial loss including but not limited to loss of profit, loss of earnings or revenue, loss of use, loss of contract or loss of goodwill except to the extent that it results from physical damage to property for which the ISO may be liable under Section 14.1.

The Commission found that these provisions were "overbroad" because they would excuse the CAISO from liability in cases of negligence or intentional wrongdoing, except in cases where such actions result in personal injury or

physical damage to property.[3] In its December 1, 1997 filing, the CAISO requested rehearing of the Commission directive regarding CAISO Tariff Sections 14.1 and 14.2.

In recent orders, the Commission determined that it was reasonable for the liability of the New York ISO to be limited, except when its actions constitute gross negligence, for activities under its Market Administration and Control Area Services Tariff ("MACAST"). In that the CAISO provides market administration and Control Area services similar to the New York ISO under its single tariff, the Commission should, at a minimum, accord it the same level of protection for its performance of the same types of activities. Moreover, the Commission should reconsider its determination that the remaining activities of an ISO cannot receive similar protections. Finally, the CAISO notes that the Commission's inclusion of an ordinary negligence standard of liability in its pro forma open access tariff is

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[3] October 1997 Order at 61,520. The Commission stated:

> It is appropriate for the ISO . . . to be protected from liability that may occur when the ISO . . . is not negligent in the performance of its responsibilities under its Tariff. . . . We believe that the determination of the ISO's . . . liability in instances of negligence or intentional wrongdoing is best left to appropriate court proceedings, in which the parties will be free to advance any appropriate argument. We direct that sections 14.1 and 14.2 of the ISO Tariff . . . be modified so as not to provide any limitation on liability of the ISO . . . in cases of [its] negligence or intentional wrongdoing.
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> Id.

currently under appellate review. If the Commission is reversed by the Court in that proceeding, it similarly should reconsider its position with respect to the liability provisions of the CAISO Tariff.

1. At a Minimum, the Commission Should, Consistent With Its Orders Concerning the New York ISO, Approve a Gross Negligence Standard for Those ISO Activities that Go Beyond Administration of Open Access Transmission Service.

In recent orders concerning the New York ISO, the Commission has recognized that ISOs perform activities that go beyond the administration of a pro forma open access transmission tariff and that, with respect to these activities, an ISO can receive the protection of a gross negligence standard of liability. At a minimum, the Commission should grant the CAISO the same level of protection accorded the New York ISO.

The New York ISO's MACAST covers such activities as: (1) ISO procedures for the operation of the New York ISO administered markets and for the safe and reliable operation of the control area (Section 3.5); (2) all functions and services related to the sale and purchase of energy or capacity and the payment to suppliers who provide ancillary services (Section 4.1);[4] (3) load forecasting (Section 4.7); (4) security constrained unit commitment (Section 4.9) and real-time dispatch (Section 4.15); (5) settlements of the ISO-administered

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[4] This includes the posting on the OASIS of bids to supply energy and ancillary services by suppliers and for posting of locational marginal prices and schedules for accepted bids by the ISO (Section 4.3).

markets (Section 4.18 and Article 7); (6) control area services (Section 5.1);[5] (7) arranging for and maintaining reliable communications and metering facilities (Section 5.8); and (8) protecting the confidentiality of data (Section 6.1).

Section 12.3 of the MACAST contains the following limitation on liability:

> The ISO, Transmission Owners and the NYSRC shall not be liable (whether based on contract, indemnification, warranty, tort, strict liability or otherwise) to any Customer, Market Participant, or any third party or other party for any damages whatsoever including, without limitation, direct, incidental, consequential, punitive, special, exemplary or indirect damages resulting from any act or omission in any way associated with a Service Agreement or ISO Services Tariff, except to the extent that the ISO, Transmission Owner or NYSRC is found liable for gross negligence or intentional misconduct, in which case, the ISO, Transmission Owner or NYSRC will not be liable for any incidental, consequential, punitive, special, exemplary or indirect damages.

Emphasis added). The Commission accepted this provision including the limitation on liability to gross negligence and intentional misconduct and the absolute limitations on incidental, consequential, punitive, special. exemplary or

[5] These services include developing and implementing procedures to maintain the reliability of the New York Power System; coordinating operations with other Control Area operators; arranging for reserve sharing agreements with other ISOs and other Control Areas to enhance reliability during abnormal operating conditions; coordinating outage schedules for generating units within the New York Control Area to maintain system reliability; committing adequate generation resources; taking command and control of resources during emergency conditions; maintaining and operating a central control center; performing the functions of the NERC security control center; defining installed capacity requirements; administering the installed capacity market; training operating personnel; and administering the NERC reliability compliance process.

indirect damages. Central Hudson Gas & Electric Corporation, et al., 88 FERC ¶ 61,138, 61,384 (1999).

More recently, the Commission approved the liability provision of the New York ISO's Market Monitoring Plan ("MMP"), which "limits the New York ISO's liability under the MMP, subject to a 'willful misconduct' standard rather than a 'negligence' standard." New York Independent System Operator, Inc., et al., 89 FERC ¶ 61,196, 61,604 (1999). The Commission noted that this provision was consistent with that approved in PJM Interconnection, L.L.C., 86 FERC ¶ 61,247 (1999), and found that the "New York ISO will not be able to properly monitor and implement measures to correct market power if the threat of lawsuits becomes a variable in its decisionmaking." New York Independent System Operator, 89 FERC at 61,604.

The fact that there is a single tariff administered by the CAISO should have no bearing on the standard of liability that should apply to the same tasks. The CAISO performs the same activities under its Tariff as those undertaken by the New York ISO under the MACAST and the MMP. For example, the CAISO administers markets for Ancillary Services and Supplemental Energy (Section 2.5 and the Ancillary Services Requirements Protocol); forecasts demand (Section 2.2.6.8 and the Demand Forecasting Protocol); dispatches units (Sections 5.1.3, 5.6, and 7.2.6.2 and the Dispatch Protocol); performs settlements for the CAISO markets (Article 11 and the Settlement and Billing Protocol); performs Control

Area services (Section 2.3., Articles 4 and 5, and the Outage Coordination Protocol); arranges for reliable communications and metering facilities (Articles 6 and 10 and the Metering Protocol); and protects data confidentiality (Section 20.3). The CAISO also is responsible for monitoring its markets (Section 2.6 and the Market Monitoring & Information Protocol).

The Commission should permit the CAISO market administration, market monitoring, and Control Area activities to enjoy the same level of protection given to the New York ISO. Thus, at a minimum, the CAISO should be liable for these activities only if the conduct arises to the standard of "gross negligence or intentional misconduct." In addition, like the New York ISO, the CAISO should be protected from "any incidental, consequential, punitive, special, exemplary or indirect damages."

2. The CAISO's Proposed Limitations on Liability and Limitations on Consequential Damages Should Be Accepted for all CAISO actions under the CAISOTariff

The Commission should allow the CAISO to limit its liability and exposure for consequential damages for all activities under its tariff. As the CAISO explained in its December 1, 1997 rehearing request, California law limits liability for public utilities. The leading case on the subject is Waters v. Pacific Telephone Company, 523 P.2d 1161 (1974). In Waters, the plaintiff sued her local telephone company on the grounds of failing to provide adequate telephone service, as required by the Public Utilities Code. However, the Court dismissed the suit on the following grounds:

> It stands undisputed that the commission has approved a general policy of limiting the liability of telephone utilities for ordinary negligence to a specified credit allowance, and has relied upon the validity and effect of that policy in exercising its rate-making functions. . . . It also appears clear that to entertain suits such as plaintiff's action herein and authorize a substantial recovery from Pacific would thwart the foregoing policy.

Id. at 1166.

The courts in California have said that the statute permitting actions for damages against public utilities for unlawful acts may only be utilized when it will not interfere with or obstruct the California Public Utilities Commission ("CPUC") in carrying out its own policies.[6] This long-standing precedent of limiting public utility liability was explained by the California appellate court in 1952. It said:

> . . . a public utility, being strictly regulated in all operations with considerable curtailment of its rights and privileges, shall likewise be regulated and limited as to its liabilities. In consideration of its being peculiarly the subject of state control, "its liability is and should be defined and limited."[7]

The CAISO is a public utility. It needs protection comparable to that enjoyed by public utilities subject to the CPUC's jurisdiction. It is obligated to file a tariff setting forth terms and conditions of operation just as would any regulated public utility. Moreover, the highly innovative nature of the California restructuring and the uniqueness of the CAISO's role exposes it to a greater risk

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[6] See, e.g., Schell v. Southern California Edison Company., 204 Cal. App. 3d 1039 (Ct. App. 2d Div. 1988).

[7] Cole v. Pacific Telephone and Telegraph Company, 112 Cal. App. 2d 416 at 419 (1952). See also Davidian v. Pacific Telephone & Telegraph Company, 16 Cal. App. 3d 750 (Ct. App. 1st Div. 1971).

of liability. The CAISO has been and will continue to be operating on the cutting edge of the field of administering what are the world's most advanced markets concerning the electric power industry. There are no preexisting industry norms or standards against which the CAISO's role and performance may be judged. Given its unique position, the CAISO merely seeks the same tariff protection that public utilities, such as Southern California Edison Company, San Diego Gas & Electric Company, and Pacific Gas and Electric Company ("PG&E"), regulated under California law, enjoy.

It is not sufficient for the issue of liability to be left to state court proceedings. First, courts treat the tariff as a contract governing the rights and liabilities of the parties. Southwestern Bell Telephone Company v. Rucker, 537 S.W.2d 326, 334 (Tex. Civ. App. 1976). Accordingly, the Commission is preventing the CAISO from relying upon a previously accepted method of reducing exposure to lawsuits. Second, the Commission should address this critical aspect of unbundled transmission service. As the Commission itself recognized in Order No. 2000, markets and entities such as the CAISO that facilitate such markets, must evolve over time.[8] The Commission should acknowledge, as it has already done in Order No. 2000, the unique role an ISO can play in the restructured electric market and should proceed cautiously to increase exposure to lawsuits inherent in an institution that by design must

[8] Regional Transmission Organizations, 89 FERC ¶ 61,285 (Order No. 2000), slip op. at 502 (1999). In fact, the Commission adopted a principle of "open architecture," requiring that a Regional Transmission Organization design have the ability to evolve over time to respond to changing market needs. Id.

simultaneously facilitate, evaluate, an adapt to an ever changing marketplace. Resolution of the liability issue will be a potential factor as transmission-owning entities make determinations whether to join regional (and potentially multi-state) transmission organizations.

The CAISO also continues to seek relief from the Commission's finding with respect to Section 14.2 of the CAISO Tariff. The proposed limit on liability for consequential or indirect loss contained in CAISO Tariff Section 14.2 is standard in almost any commercial environment, particularly where the consequential or indirect loss could be very substantial.

The Commission has routinely accepted tariff provisions limiting a jurisdictional entity's liability for consequential damages. It accepted a tariff provision that contained a waiver of consequential damages in National Fuel Gas Supply Corporation, where it found that the waiver would help implement the service and would not be detrimental to the system.[9] In Shell Gas Pipeline Company,[10] the Commission approved a provision which excluded punitive, incidental, consequential or special damages from the indemnity provisions of the pipeline's tariff. The Commission noted that such limitations were approved in other pipeline tariffs and that pipelines and shippers are not required to indemnify

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[9] 80 FERC ¶ 61,040 at 61,121 (1997).

[10] 76 FERC ¶ 61,126 at 61,692-93 (1996). See Southern Natural Gas Company, 64 FERC ¶ 61,274 at 62,925-26 (1993).

each other against consequential damages while gas is in their possession and control.[11] The CAISO seeks similar protection.

While restructuring the natural gas industry, the Commission dealt with the propriety of allowing consequential damages. For example, in Arkla Energy Resources Company *("*AERCo*"),*[12] the company proposed a tariff provision that limited its liability to general damages only. It disallowed special, continuing, exemplary, presumptive or other such elements of damage. A customer claimed that such limitation was unfair to the shipper. The Commission disagreed:

> The present approved tariff does not require AERCo to compensate for consequential damages. The Restructuring rule, [i.e*.,* Order No. 636] does not require that a pipeline accept liability for consequential damages. There is simply no basis for requiring AERCo to increase its liability exposure in this manner*.*

64 FERC ¶ 61,166, 62,491 (1993).

In Order Nos. 888 and 888-A,[13] the Commission held, as with its treatment of indemnification, that such issues should be left to state law. Under California

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[11] Id.

[12] 64 FERC ¶ 61,166 at 62,488 (1993).

[13] Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540, Federal Energy Regulatory Commission, Statutes and Regulations, Regulations Preambles January 1991-June 1996 ¶ 31,036 at 31,765 -66, (1996), order on reh'g, Order No. 888-A, 62 Fed. Reg. 12,274 (1997), FERC Statutes and Regulations ¶ 31,048 at 30,302 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

law, utilities have been protected from consequential damages even in a competitive environment.[14] As explained above, the unique nature of the CAISO necessitates that it should be comparably treated.

Consequential damages compensate a plaintiff for the loss of income or profit due to a breach of contract or a tortious event, but they often present difficult problems:

> One of these lies in the fact that consequential damages may stretch indefinitely in time. It is hard to be confident about proof of consequential damages, and it is easy to extend the claims. Consequential losses may easily exceed the risk created by the defendant's tort or those guaranteed by contract. Consequential damages are costly to prove and litigate, both for the parties and for courts. Consequential damages also run the risk of duplicated recoveries, if consequential damages are added to any other measures of relief.

Dobbs, 1 Law of Remedies 305 (2d ed. 1993). In the context of public utilities, there is a direct relationship between rates and liability exposure. The Commission must not permit the benefits of independent transmission service to be lost through increased lawsuits that will entail potentially unimaginable consequences.

The Commission should accept CAISO Tariff Sections 14.1 and 14.2 as proposed by the CAISO. Commission precedent, California law, and sound

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[14] Rulemaking on the Commission's Own Motion to Establish a Simplified Registration Process for Non-Dominant Firms, Investigation on the Commission's Own Motion to Establish a Simplified Registration Process for Non-Dominant Telecommunications Firms, Decision 96-09-098, 1996 WL 656757, 68 CPUC 2d 352 (1996).

public policy all support a limitation of liability and damages under the CAISO Tariff.

3. The Application of a Negligence Standard Is Inappropriate.

In Order No. 888, the Commission modified the language that was present in the Notice of Proposed Rulemaking ("NOPR") concerning the liability of a transmission provider. The NOPR had limited a transmission provider's liability to instances of gross negligence or intentional wrongdoing. See Pro Forma Point To Point Transmission Tariff, Section 23.0, at 60; Pro Forma Network Integration Service Transmission Tariff, Section 15.0, at 40. In Order No. 888, the Commission revised the provision to provide that "the customer will not be required to indemnify the transmission provider in the case of negligence or intentional wrongdoing by the transmission provider."[15]

The Commission has stated that the intent of the October 1997 Order was to require the CAISO to adopt the liability and indemnification provisions of the Order No. 888 pro forma tariff without modification.[16] The CAISO recognizes that the issue of whether the liability provisions of the pro forma tariff are legally justifiable is being considered by the United States Court of Appeals for the District of Columbia Circuit in Transmission Access Policy Study Group v. FERC,

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[15] Order No. 888, 61 Fed. Reg. 21,540, Federal Energy Regulatory Commission, Statutes and Regulations, Regulations Preambles January 1991-June 1996, ¶ 31,036 at 31,765-66.

[16] Central Hudson Electric & Gas Corporation, et al., 86 FERC ¶ 61,062 at 61,210 (1999)("Consistent with our approach in WEPEX, we will require that the New York ISO Tariff be modified to adopt the indemnification provisions in the pro forma tariff, without modification." See also October 1997 Order at 61,520.

Case No. 97-1715, the appeal of Order Nos. 888, 888-A, 888-B, and 888-C. Certain appellants in that case have noted: (1) that the general practice in the country is that utilities should be permitted to limit liability except in cases of willful misconduct or gross negligence; (2) that these limitations strike an appropriate balance between lower rates for all customers with the increased burden of recovery for some; and (3) that prior to Order No. 888, the Commission had accepted similar limitations on liability.[17]

The CAISO has explained above why it believes the Commission should grant rehearing and affirm the liability provisions of the CAISO Tariff as proposed, without awaiting the outcome of the Order No. 888 appeal. Nevertheless if the Court rejects the liability provisions of the pro forma tariff, the CAISO would expect that the Commission would similarly reconsider its prior findings on this issue with respect to the CAISO Tariff.

4. Conclusion

The CAISO respectfully requests that the Commission reinstate CAISO Tariff Section 14.1 as originally written or at a minimum allow the CAISO to apply a gross negligence standard to its Tariff. The following is a proposed alternative:

> The ISO shall not be liable in damages to any Market Participant, End-User, or any third party or other party for any losses, damages, claims, liability, costs or expenses (including legal expenses) arising from the performance or nonperformance of its obligations under this ISO Tariff, except to the extent that its breach of the

[17] Transmission Access Policy Study Group v. FERC, Case No. 97-1715, Brief of Investor Owned Utility Petitioners (dated Aug. 19, 1999), at 25-40.

provisions of the ISO Tariff results directly from gross negligence or willful misconduct.

In the event that the Commission does not approve application of the gross negligence standard for all CAISO activities, the Commission should at a minimum approve the application to the CAISO activities of the same liability standard as has been allowed for the New York ISO under the MACAST and the Market Monitoring Plan.

With respect to CAISO Tariff Section 14.2, the Commission should, in accordance with its past precedent, state law, and sound public policy limit the CAISO's exposure to consequential or indirect losses. CAISO Tariff Section 14.2 is a standard commercial contract provision, particularly in situations where the potential consequential or indirect losses are significant. Again, at a minimum, the Commission should permit the CAISO the same absolute limitations on incidental, consequential, punitive, special. exemplary or indirect damages as it approved for the New York ISO under the MACAST.

B. Whether the MSS concept under the CAISO Tariff should be limited so that it would only be used as a vehicle to respect existing operational capabilities for Existing Rights holders? [Issue No. 677, Docket Nos. EC96-19-009 and ER96-1663-010]

The CAISO Tariff defines an MSS as:

> A system of an Existing Operating Entity as at the ISO Operations Date which has been operating for a number of years subsumed within the ISO Controlled Grid and encompassed by revenue quality meters at each interface point with the ISO Controlled Grid which is operated in accordance with Existing Contracts and an Existing Operating Agreement.

The MSS concept was introduced into the CAISO Tariff to facilitate participation by existing Governmental Entities that had been operating under

longstanding interconnection agreements with the Participating Transmission Owners who had turned control of their transmission facilities over to the CAISO. It was envisioned as a potential transitional mechanism to enable such entities to continue to utilize their Existing Rights and to participate in the CAISO's markets, without requiring certain changes in the operations of their systems. The MSS definition was intended to respect and accommodate existing operational capabilities for Existing Rights holders that operate discrete utility systems that interconnect with the ISO Controlled Grid at one or more points at which revenue-quality meters are located. Resolving all of the operational, data collection, and cost allocation issues associated with implementation of the MSS concept has been extremely difficult, and it remains a work in progress.

In the October 1997 Order, the Commission urged the CAISO to consider how a Scheduling Coordinator would qualify as a Metered Subsystem operator:

> We note that the ISO Tariff allows a Scheduling Coordinator to become a Metered Subsystem operator if it meets the ISO's technical requirements for metering and communications. We also note that . . . the ISO/PX states that after January 1, 1998, the Tariff will be revised to clarify the role, responsibility and requirements associated with Metered Subsystems and that this delay is due to the complexity in implementation. Many parties state that allowing a Scheduling Coordinator to qualify as a Metered Subsystem operator is critical. We agree that this is a critical feature and urge the ISO Governing Board to consider this issue with a high priority.

October 1997 Order at 61,496.

On October 31, 1997, the CAISO filed its pro forma Existing Operator Agreement ("EOA"), which would serve as the governing contractual document for an entity operating an MSS. The EOA set out the rights and responsibilities

of the CAISO and the Existing Operating Entity ("EOE") with respect to an "Existing Operating Arrangement" (i.e., a pre-existing interconnection agreement) under which: (1) the EOE would deliver the output of its Generation to its Demand as a system function, and (2) the EOE would be treated as an MSS under the CAISO Tariff.

In its December 1, 1997 rehearing request, the CAISO requested clarification that it could limit MSS status to those entities that had qualified for and had executed EOAs.[18] The CAISO explained that it was never intended that new MSSs should be created by allowing Scheduling Coordinators to acquire physical assets or associated contract rights. In its order dated December 17, 1997, the Commission conditionally accepted the pro forma EOA.[19]

The CAISO has worked diligently to develop a MSS concept that can be implemented consistent with other requirements of the CAISO market structure.[20]

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[18] December 1, 1997 Requests for Rehearing, Motion for Stay and Motions for Clarification, at 27-31.

[19] Pacific Gas and Electric Company, et al., 81 FERC at 62,474-75. The pro forma EOA as accepted provides that "[t]he Existing Operating Arrangement reflected in this Agreement has been in place for a number of years pursuant to the provisions of the Interconnection Agreement." Pro forma EOA at 1.

[20] As early as June 3, 1998, the CAISO solicited the participation of Governmental Entities with Existing Contracts in the Existing Rights Working Group ("ERWG"). The CAISO held stakeholder meetings or conference calls on June 23, July 7, July 22, September 11, September 17, October 14, October 20, November 3, November 13, November 16, and November 24, 1998. The highest priority topic of those meetings and conference calls was the subject of MSS and System Unit issues. The CAISO devoted extensive efforts to (1) exploring alternative approaches in order to expedite the implementation of the MSS and System Unit concepts, and (2) developing its initial position on the extent to

The CAISO recognizes that no entities executed EOAs prior to the ISO Operations Date and that this restriction must be modified. However, it nevertheless remains appropriate that MSS status be limited, as a transitional mechanism, to entities such as the Governmental Entities operating under pre-existing agreements.

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which the CAISO could justify exceptions from the ordinary application of the CAISO Tariff to an MSS and System Unit.

Given the obstacles posed by the need for CAISO system "workarounds" (i.e., the need to deviate from the CAISO's automated systems), the CAISO received express direction from the participants in the ERWG that the CAISO was to endeavor to develop an "interim" approach to Existing Contract holder participation in the CAISO's markets in an attempt to facilitate participation in the CAISO's markets by the summer of 1999. In response to that direction, the CAISO explored the possibility that the Existing Contract holders and PG&E might be flexible enough in their administration of their Existing Contracts and their other operations to accommodate the existing structure of the CAISO's systems in the short term – pending the CAISO's ability to implement any necessary software modifications in the long term. In November 1998, the CAISO circulated a set of MSS principles for discussion purposes. After additional discussions with stakeholders and management, the CAISO circulated a far more detailed set of principles in March 1999. During 1999 and into 2000, the CAISO has met with various stakeholders to further develop the MSS concept.

The CAISO is currently in the process of developing a unified approach to all matters that affect Governmental Entities and other Existing Contract holders within the CAISO Control Area in conjunction with the CAISO's mandated obligation to develop a new transmission access charge methodology. Because both the form of that methodology and the terms upon which the MSS concept is implemented may have significant operational and financial consequences for Governmental Entities and other Existing Contract holders, the CAISO has attempted to integrate a new proposal for implementation of the MSS and System Unit concepts with a proposed approach to the access charge.

The MSS concept was intended as a vehicle to address unique concerns of Governmental Entities that operated integrated utility systems interconnected with the transmission facilities of a Transmission Owner that transferred Operational Control to the CAISO and had an Existing Contract governing that relationship. It was designed to coordinate the operation of these activities with the new market and transmission structure while honoring Existing Rights. The CAISO does not believe that the Commission's reference to Scheduling Coordinators qualifying as MSSs was intended to expand the scope of this concept. Rather, the reference recognizes that all market interaction by the CAISO is with Scheduling Coordinators. The Load and resources of an existing Governmental Entity that qualifies as an MSS must be represented by a Scheduling Coordinator, whether the EOE itself qualifies as a Scheduling Coordinator or contracts with some other entity to represent its Load and resources. A Scheduling Coordinator could thus "qualify as a Metered Subsystem" when it represents the Loads and resources within an existing utility system and satisfies the technical requirements that will be developed.

The CAISO is concerned that a failure to limit the intended rationale and scope of MSS could lead to the balkanization of the ISO Controlled Grid. Entities seeing an advantage in an MSS could construct or acquire facilities to try to create new utility systems and claim MSS status. This effectively could withdraw facilities from integrated regional control and from open access under the CAISO Tariff leading to pancaked rates and other market impediments. Moreover, the CAISO has market mechanisms already in place to allow Generators to combine

units. The CAISO Tariff provides for Physical Scheduling Plants ("PSPs") facilitating combined operation of units in the same location.[21] Certain Market Participants, however, are trying to expand the MSS concept as a way to permit portfolio bidding of resources from widely separated locations.[22] As noted above, the MSS concept should be limited to existing integrated utility systems that have Existing Contracts with Participating Transmission Owners. Moreover, while the CAISO recognizes the flexibility portfolio bidding provides in managing resources in forward Energy markets (including the California Power Exchange markets), such an approach raises questions as to how the system operator becomes aware of the specific resources needed to control the transmission system and maintain reliability. The CAISO also notes that the Commission recently raised concerns about portfolio bidding in its Regional Transmission Organization Final Rule.[23] The Commission stated that "since large players are more likely to cause market power problems, a market design that favors large players (e.g., portfolio bidding) may create an incentive for consolidation and resulting market power problems." Id. (footnote omitted).

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[21] PSPs are groups of generating units that must be operated together either because of physical necessity or operational design but which are equally effective in satisfying the CAISO's locational needs (whether Energy or capacity) regardless of which unit is actually dispatched. The CAISO has always been willing to provide flexibility with regard to the dispatch and operation of entities whose resources are so situated.

[22] See Unresolved Issue No. 294.

[23] Regional Transmission Organizations, slip op. at 640.

While it may be appropriate to facilitate participation in the market by entities operating under existing contractual arrangements, the CAISO believes it is inappropriate and inconsistent with the provisions of open access to broaden the scope of this artifact of restructuring. MSS has always been only a potential means to accommodate the transition of entities operating under existing contractual arrangements into the new market paradigm.

For the reasons stated above, the CAISO respectfully requests that the Commission, consistent with its acceptance of the pro forma EOA, clarify that MSS status should be limited to entities that had been operating as utilities, prior to the formation of the CAISO, under Existing Contracts.

C. Whether End-Use Meters of CAISO Metered Entities should all be grandfathered or whether there should be a case-by-case evaluation? [Issue No. 675, Docket Nos. EC96-19-009 and ER96-1663-010]

In the March 31, 1997 filing, the CAISO Tariff language stated that metered entities (Section 10.2.4) and all End-Users (Section 10.6.4) shall ensure that their meters are in conformance with Appendix J. Section 10.6.6.2 provided that all End-Use Meters in place as of the ISO Operations Date would be deemed to be certified.

In the August 15, 1997 filing, the CAISO separated metered entities into ISO Metered Entities ("ISOMEs") and Scheduling Coordinator Metered Entities ("SCME"). An ISOME includes any entity directly connected to the ISO Controlled Grid, including an End-User (other than an End-User who purchases all of its Energy from the Utility Distribution Company ("UDC") in whose Service

Area it is located). Each ISOME is required to provide Meter Data by direct interface between the CAISO's Meter Data acquisition and processing system and the ISOME's CAISO-certified revenue quality meter or compatible meter data server. For ISOMEs, the CAISO is responsible for the validation, editing, and estimation of the Meter Data in order to produce Settlement Quality Meter Data. In contrast for SCMEs, it is the responsibility of the Scheduling Coordinator to validate, edit, and estimate the Meter Data and provide the Settlement Quality Metered Data to the CAISO. The Scheduling Coordinator must ensure that the metered entities it represents adhere to the requirements and standards for metering facilities set by the Local Regulatory Authority or, in the event that the Local Regulatory Authority has no such requirements, to the requirements of the CAISO.

In the August 1997 filing, the CAISO divided Article 10 of the CAISO Tariff such that Sections 10.1 through 10.5 only applied to ISOMEs, and Section 10.6 only applied to SCMEs. However, Section 10.6 was the only section that explicitly grandfathered certification for End-Use Meters in place as of the ISO Operations Date. In the October 1997 Order, the Commission directed the CAISO to amend CAISO Tariff Section 10.2.4 to be consistent with PG&E's suggestion to grandfather End-Use Meters of ISOMEs as well. The CAISO made this revision in its June 1, 1998 Compliance filing.

The CAISO seeks to confirm that the Commission's purpose in the October 1997 Order was to change section 10.2.4 to make it clear in the CAISO Tariff that the End-Use Meters of ISOMEs would be deemed to be certified but

not to override other CAISO Tariff provisions under which the CAISO can require upgrades to meters of ISOMEs where necessary to maintain system reliability or enhance operation of the CAISO markets.

> Under Section 10.2.2 of the CAISO Tariff, the CAISO may require ISO Metered Entities to install, at their cost, additional meters and relevant metering system components, including real time metering, at ISO specified Meter Points or other locations as deemed necessary by the ISO, in addition to those connected to or existing on the ISO Controlled Grid at the ISO Operations Date, including requiring the metering of transmission interfaces connecting Zones.

In its December 1, 1997 filing, the CAISO noted that certain meters are important operationally depending on their size, location or other factors likely to have an impact on dispatch by the CAISO. The CAISO proposed to develop criteria which could require some, but not all, End-Use Meters of ISOMEs to comply with the CAISO standards in relation to metering and direct polling after a grace period.[24]

The CAISO continues to believe that it may be important to identify certain categories of End-Use Meters of ISOMEs that should be upgraded. The CAISO has experienced examples of high Unaccounted for Energy calculations due to meter error. The CAISO also has concerns that certain grid-connected loads may not be meeting the power factor requirements specified in Section 2.5.3.4 of the CAISO Tariff. The CAISO recognizes, however, that it would be appropriate to discuss these concerns and potential solutions with stakeholders.

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[24] December 1, 1997 CAISO Requests for Rehearing, Motion for Stay and Motions for Clarification, at 9.

Moreover, we note that on January 7, 2000, the Commission issued an order with respect to the proposed Amendment No. 23 to the CAISO Tariff. California Independent System Operator Corporation, 90 FERC ¶ 61,006 (2000). The Commission directed the CAISO to reevaluate its approach to Intra-Zonal Congestion management on "a comprehensive, rather than piecemeal, basis." Id. at 61,010. The determination of a revised approach to Intra-Zonal Congestion management may have an effect on the CAISO's metering, data collection, and communication requirements. The CAISO has committed to undertake a broad-based review of potential approaches to Intra-Zonal Congestion management.[25]

Accordingly, the CAISO requests that the Commission confirm that it did not intend to revoke the CAISO's authority under Section 10.2.2 to require necessary upgrading of meters, including End-Use Meters of ISOMEs in place on the ISO Operations Date. The issue of potential meter upgrades needs to be considered further with stakeholders. Only if the CAISO determined as a result of the stakeholder process that it would be necessary to propose that certain categories of End-Use Meters of ISOMEs warranted upgrading, would it seek to require such improvements.

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[25] Motion for Clarification or, In the Alternative, Request for Rehearing, and Request for Expedited Consideration, Docket No. ER00-555-000 (filed Feb. 7, 2000), at 2.

IV. Conclusion

WHEREFORE, for the reasons discussed above, the Commission should grant the relief requested herein.

Respectfully submitted,

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Date: February 14, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents by first class mail, postage prepaid, upon each person designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this Proceeding.

Dated at Washington, D.C. on this 14th day of February, 2000.

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