

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

California Independent System
Operator Corporation

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Docket No. EL02-45-001

**MOTION FOR CLARIFICATION OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

This motion concerns the proper allocation of sums potentially in excess of \$50 million incurred by the California Independent System Operator Corporation (“ISO”) in procuring Ancillary Services to meet its obligations under the ISO Tariff and under state law. By orders dated May 10, 2004 and April 18, 2005,¹ the Commission concluded that the ISO lacks authority under its tariff to bill Pacific Gas & Electric Company (PG&E) for Ancillary Services procured in connection with certain “off grid” transactions.² In so concluding, the Commission left unanswered questions concerning (1) which party or parties *should* be billed for the reliability services at issue, and (2) the ISO’s authority generally to consider “off grid” transactions in setting requirements for and procuring Ancillary Services to meet its legal obligations. Accordingly, the ISO seeks a further order of the Commission, pursuant to Rule 212 of the Commission’s

¹ Order Denying Petition for Review, issued on May 10, 2004, 107 FERC ¶ 61,152 (2004) (“May 10 Order”) and Order Denying Rehearing, issued on April 18, 2005, 111 FERC ¶ 61,078 (2005) (“April 18 Order”).

² The ISO does not seek to challenge this ruling for purposes of this motion. However, the ISO reserves its right to contest this decision as necessary to preserve its right to judicial review.

Rules of Practice and Procedure, 18 C.F.R. § 385.212, clarifying that, under its May 10 and April 18 Orders:

- (1) the ISO is entitled to seek recovery of the costs at issue from all users of the ISO Controlled Grid, consistent with relevant tariff provisions; and
- (2) the ISO is not precluded, under such orders, from taking “off grid” transactions into account in setting requirements and procuring reliability services to meet its legal obligations.

I. INTRODUCTION

As noted above, this proceeding concerns the proper allocation of costs of Ancillary Services that the ISO procured in order to comply with ISO Tariff provisions that require the ISO to procure Ancillary Services in a manner that is consistent with WECC (formerly the WSCC) Minimum Operating Reliability Criteria (“MORC”) and with NERC Reliability Criteria. The ISO procured the Ancillary Services at issue based on Loads served by the California Oregon Transmission Project (“COTP”), which is within the ISO’s Control Area (and is connected to the ISO Controlled Grid), but is not part of the ISO Controlled Grid (hereinafter, sometimes “Grid”). The issue – resolved in an arbitration and appealed to the Commission – was whether the ISO could bill such costs to PG&E as the Scheduling Coordinator for parties engaged in transactions on the COTP. The AAA Order resolved that question in the negative.³ In its Orders denying the ISO’s petition for review of the AAA Order and denying rehearing, the Commission included some language that creates ambiguity regarding (1) the ISO’s ability to seek recovery of the costs of the Ancillary Services the ISO procured, and (2) the ISO’s

³ *Pacific Gas and Electric Co.*, American Arbitration Association Case No. 71 198 00711 00, at p. 21 (the “AAA Order”).

ability to apply WECC criteria and, in particular, to take into account off-Grid, Control Area transactions, for purposes of procuring the amount of Ancillary Services necessary to maintain the reliability of the ISO Controlled Grid.

Although the Orders could be read in several ways, the ISO believes that the only reasonable interpretation of the Orders is that (1) the ISO can take into consideration off-Grid, Control Area transactions when procuring Ancillary Services needed to maintain Grid reliability, and (2) the ISO is authorized to allocate such charges to all Load on the ISO Controlled Grid. The former point is consistent with the ISO's obligation to procure Ancillary Services "consistent with [WECC] and NERC criteria"⁴ – an obligation that is plain on the face of the ISO Tariff and that no party questioned in the proceedings below. The latter point is consistent with the AAA Order, which found that it was within the ISO's judgment to procure the Ancillary Services at issue and that it would not be unreasonable for the ISO to bill these charges to the market.⁵

The ambiguity of the Commission's Orders must be resolved because it threatens the ISO's ability to maintain the reliability of the ISO Controlled Grid by following the reliability criteria mandated by the ISO Tariff and state law, *i.e.*, WECC and NERC reliability standards, which specify Operating Reserve requirements on a Control Area-wide basis. The ISO cannot simply island the ISO Controlled Grid from the rest of the Control Area. If the ISO lacks adequate Ancillary Services to respond to an off-Grid contingency, it will expose the ISO Controlled Grid to the potential for blackouts.

⁴ ISO Tariff Section 2.5.1.

⁵ AAA Order at pp. 20-21.

The Commission's Orders also create problematic ambiguity regarding the ISO's ability to charge for the Ancillary Services that it procures in order to maintain Grid reliability. At issue is an amount in excess of \$50 million that the ISO paid to providers of Ancillary Services, part of which was billed to PG&E and part of which has been billed to users of the ISO Controlled Grid. Based on the AAA Order and the Commission's Orders, the ISO believes it appropriate to charge all of the costs to users of the ISO Controlled Grid. Other parties, however, could use the ambiguity in the Commission's Orders to challenge the ISO's ability to recover the costs of these Ancillary Services from the users of the ISO Controlled Grid. Therefore, the ISO seeks clarification that the Commission intended that the ISO be able to recover all of these costs from users of the ISO Controlled Grid.

II. BACKGROUND

PG&E paid approximately \$14.2 million for Ancillary Services procured by the ISO in support of transactions that PG&E scheduled with the ISO on the COTP from April 1998 through April 1999. The ISO has billed users of the ISO Controlled Grid a sum greater than \$38 million for Ancillary Services in support of COTP schedules submitted from May 1999.

During the arbitration, the ISO presented evidence that the ISO Tariff requires the ISO to procure Ancillary Services consistent with the WECC (then WSCC) and NERC criteria, and regarding the meaning of those criteria. As the evidence showed,

these criteria operate on a Control Area basis.⁶ The evidence regarding the nature of the reliability criteria was uncontroverted. In fact, even PG&E admitted that the ISO has “the responsibility to assure reliability of the larger Control Area” by, among other things, “mak[ing] sure that there are adequate Ancillary Services supporting loads in the Control Area.”⁷

In his Order, the arbitrator determined that the ISO’s “authority to procure [Ancillary] Services and charge the cost to Scheduling Coordinators does not embrace transactions off the ISO Controlled Grid, such as COTP and Bubble.”⁸ Nevertheless, the arbitrator stated that he was mindful of the ISO’s argument that the purchase of Ancillary Services for off-ISO Controlled Grid Load was a legitimate ISO responsibility carried out in good faith⁹ and concluded that “spreading these costs across all participants in that structure [*i.e.*, the restructured California market] is not unreasonable in such circumstances.”¹⁰

The ISO petitioned the Commission for review of the AAA Order.¹¹

In the May 10 Order, the Commission affirmed the arbitrator’s decision. The Commission noted,

The arbitrator framed the issue as whether the ISO had the requisite legal authority to impose upon PG&E charges for ancillary services in connection with transactions scheduled on the COTP and Bubble facilities. The arbitrator

⁶ AAA Hearing Transcript at 51:22-52:1 (“Tr.”); Exhibits ISO-8 & ISO-22, in Evidentiary Record submitted by the ISO on January 25, 2002, in Docket No. EL02-45-000 at 04644-04711, 05563-05656 (“Record”).

⁷ Tr. 52:16-23; 52:24-53:3, 889:17-19; 893:22-894:1.

⁸ AAA Order at 7.

⁹ *Id.* at 20.

¹⁰ *Id.* at 21.

¹¹ ISO Petition for Review of Arbitrator’s Award, filed January 4, 2002 in Docket No. EL02-45-000.

concluded that the ISO Tariff did not provide the ISO with authority to impose charges related to these transactions.¹²

The Commission also stated, however,

we agree with the arbitrator that the ISO Tariff limits the ISO's authority to procure ancillary services to ISO-controlled grid transactions, and that the arbitrator correctly concluded that the ISO Tariff does not authorize the ISO to impose upon PG&E charges for ancillary services in connection with COTP and Bubble transactions since they are not included within the ISO-controlled grid.¹³

The Commission did not consider the ISO's arguments, in support of its position on the cost allocation question, that the ISO Tariff specifically authorizes the ISO to establish standards and procure Ancillary Services in an amount it concludes to be necessary to protect the reliability of the ISO Controlled Grid consistent with WECC and NERC standards, and that those standards require the ISO to take account of all Loads in its Control Area in order to protect the reliability of the Grid.¹⁴

On rehearing, the ISO expressly requested that the Commission confirm that the May 10 Order did not limit the authority of the ISO to determine the quantity of Ancillary Services necessary to maintain the reliability of the ISO Controlled Grid consistent with applicable reliability standards.¹⁵ Although the April 18 Order, in denying rehearing, acknowledged the ISO's request for clarification of the ISO's authority to establish

¹² May 10 Order at P 4.

¹³ *Id.* at P 29.

¹⁴ May 10 Order at P 32. The Commission concluded that these arguments had not been raised before the Arbitrator. In this respect, as the ISO noted in its Reply Brief, the Commission is incorrect; the ISO did raise these arguments before the Arbitrator. As discussed below, the Arbitrator recognized the ISO's need to procure Ancillary Services to fulfill its WECC and NERC responsibilities, but nevertheless found that the ISO's authority to procure such Ancillary Services did not constitute a sufficient basis for charging any of the associated costs to PG&E. AAA Order at 20.

¹⁵ ISO Motion for Clarification, Request for Rehearing and Conditional Motion for Stay, filed June 9, 2004 in Docket No. EL02-45-000, at 3.

standards for or to procure Ancillary Services, the ruling did not address the substance of the request.

III. ARGUMENT

A. The ISO Is Entitled To Charge the Costs at Issue to All Users of the ISO Controlled Grid

The costs for the Ancillary Services in question have been paid to the suppliers. The AAA Order, sustained by the Commission, awarded PG&E return of the approximately \$14.2 million it had paid the ISO for these costs. Both the ISO Tariff and the Commission's Orders in this proceeding compel the conclusion that these sums should be billed to users of the ISO Controlled Grid.

As the Commission is aware, the ISO is a revenue-neutral entity, so that it must have an external source for the amount to be returned to PG&E. Section 13.5 of the ISO Tariff governs circumstances such as these, when a dispute over the ISO's billings and payments results in an arbitration award requiring that sums previously paid into the ISO settlements system be returned. Section 13.5.3.1 states as follows:

The ISO will use best efforts to determine which Market Participant(s) is or are responsible for and/or benefit from payment of an award by or to the ISO and to allocate receipt of or payment for the award equitably to such Market Participant(s).

The ISO submits that pursuant to Section 13.5.3.1, it is appropriate that the costs of the Ancillary Services at issue be borne *pro rata* by all users of the ISO Controlled Grid. The evidence before the arbitrator established that the Ancillary Services at issue

benefited users of the ISO Controlled Grid.¹⁶ Moreover, the arbitrator found that it would be appropriate to spread the costs of these services to those users. Specifically, the arbitrator concluded that:

[i]t was within Cal ISO's judgment to determine what was required by its responsibility as operator of a Control Area wider than that which PG&E operated using the ancillary service self-provision arrangements in place with [the governmental entities]. . . . Cal ISO exercised its judgment to operate on a basis that did not take into account these existing arrangements. It was further Cal ISO's judgment to procure, in these circumstances, additional Ancillary Services related to COTP and Bubble schedules.

. . .

It was the structure put in place by the decision to revamp the California electric industry and to create and vest Cal ISO with its Control Area responsibilities that led to these added costs for COTP and Bubble related ancillary services. The arbitrator concludes that spreading those costs across all participants in that structure is not unreasonable in such circumstances.¹⁷

The Commission's May 10 and April 18 Orders also compel the conclusion that the costs of the Ancillary Services at issue should be paid by users of the ISO Controlled Grid. Based on the language in Tariff provisions that reference reliability of the ISO Controlled Grid, the arbitrator concluded, and the Commission affirmed, that it was improper for the ISO to bill the cost of these Ancillary Services to those who did not use the ISO Controlled Grid. According to the logic of these same Tariff provisions,

¹⁶ The evidence established that the ISO Controlled Grid could be jeopardized if supply behind an off-Grid Schedule should fail and the ISO had not ensured sufficient Ancillary Services to back up that Schedule. As the evidence showed, if a Generator serving Load in the ISO's Control Area through deliveries over the facilities such as the COTP experiences an unplanned shutdown, an imbalance between Generation and Load in the ISO's Control Area – which includes off-ISO Controlled Grid Loads – will result. Tr. 223:7-224:10; Tr. 1093:3-1094:20; Tr. 1156:20-1157:3. If that imbalance, which shows up in the ISO's monitoring systems, is not corrected, the reliability of the entire Control Area, including the reliability of the ISO Controlled Grid, will be put at risk. Exh. ISO-8, Record at 04668-71. Thus, a failure of supply delivered over off-ISO Controlled Grid transmission facilities can, and likely will, affect "the reliable operation of the ISO Controlled Grid." ISO Tariff Section 2.5.2.1.

¹⁷ AAA Order at 20-21 (emphasis added). The arbitrator made this finding in support of his decision that the Ancillary Services costs should not be billed to PG&E. Presumably, the Commission considered this finding in affirming the AAA Order.

those who do use the ISO Controlled Grid are the proper parties to be billed for the Ancillary Services procured to protect that Grid; nothing in the language or logic of the AAA Order or the Commission's Orders is contrary to this conclusion.

Absent clarification of the May 10 and April 18 Orders, however, parties may use these Orders to allege that the ISO lacked authority to procure the Ancillary Services in question and therefore cannot allocate the costs to users of the ISO Controlled Grid. Accordingly, consistent with the AAA Order and Section 13.5.3.1 of the Tariff, the Commission should clarify that the ISO may allocate the costs of the Ancillary Services it procured to users of that Grid.

B. The Commission Should Clarify That the ISO May Take Into Account Schedules Off the ISO Controlled Grid in Setting Requirements for and in Procuring Ancillary Services To Ensure Reliability of the ISO Controlled Grid

The Commission's Orders contain language that should not reasonably, but nonetheless could, be construed to undermine the ISO's ability to procure reliability services in a manner consistent with long-established industry standards.¹⁸ The ISO sought clarification of this troublesome language with its rehearing petition,¹⁹ but the Commission did not address that request. Given the fundamental importance of this issue, the ISO renews its motion for clarification.

¹⁸ As the Commission is aware, the ISO is obligated under California law to follow such industry criteria. *California Independent System Operator Corp.*, 99 FERC ¶ 63,020 at 65,104 n.48 (2001) ("California Public Utilities Code, section 345 requires the ISO to 'ensure the efficient use and reliable operation of the transmission Grid consistent with the achievement of planning and operating reserve criteria no less stringent than those established by the Western Systems Coordinating Council and the North American Electric Reliability Council.'"); see also Cal. Pub. Util. Code Sec. 345 (2005).

¹⁹ Motion for Clarification, Request for Rehearing and Conditional Motion for Stay of the California Independent System Operator Corporation, filed on June 9, 2004 in Docket No. EL02-45-000 at 1-2, 8-13.

The problematic language appears in the Commission's explanation of why PG&E could not be billed for the Ancillary Services at issue. The language should properly be understood as addressing a question of appropriate cost allocation. Unfortunately, however, a party intent on creating mischief could argue that the Commission went further than addressing the cost allocation issue and restricted the ISO's ability to consider off-Grid, Control Area transactions in determining the amount of Ancillary Services necessary to ensure the reliability of the ISO Controlled Grid. To cut off any potential for such an argument – which could wreak havoc with the ISO's fulfillment of its obligations to maintain Grid reliability – the ISO again seeks clarification.

Troublesome language first appears in Paragraph 28 of the May 10 Order:

The ISO Tariff states that the ISO is responsible for procuring ancillary services *only* for the ISO-controlled grid, and thus it may seek reimbursement of the costs of ancillary services from customers that use the ISO-controlled grid. The ISO Tariff does not provide, as the ISO argues, that the ISO can apply those provisions to off-grid transactions within the ISO control area.

Further, in Paragraph 29, the Commission stated: “we agree with the arbitrator that the ISO Tariff limits the ISO's authority to procure ancillary services to ISO-controlled grid transactions” Another potentially ambiguous passage is in Paragraph 3 of the April 18 Order: “In the May Order the Commission agreed . . . that the ISO Tariff limited the ISO's authority to procure ancillary services to ISO-controlled grid transactions.” The ISO is concerned that parties could rely on these statements to support positions that (1) the ISO is precluded from taking into consideration off-Grid, Control Area transactions in determining the quantity of Ancillary Services that the ISO needs to purchase to maintain reliable operations on the ISO Controlled Grid, and/or (2) the ISO should not be permitted to charge users of the ISO Controlled Grid for Ancillary

Services procured on the basis of off-Grid, Control Area transactions. Such positions are unsupported on the basis of the ISO Tariff, California law, or other Commission decisions. The ISO asks the Commission to clarify that such positions also are unsupported on the basis of this language in the May 10 and April 18 Orders.

The ISO Tariff makes clear beyond dispute that the ISO must consider schedules off the ISO Controlled Grid, but within the Control Area, in determining the amount of Ancillary Services to procure. Section 2.5.1 of the ISO Tariff provides as follows:

The ISO shall be responsible for ensuring that there are sufficient Ancillary Services available to maintain the reliability of the ISO Controlled Grid *consistent with WECC and NERC criteria*.

(Emphasis added.) Also, in order to maintain the reliability of the ISO Controlled Grid, the ISO must comply with WECC and NERC Operating Reserve criteria. Section 2.3.1.3.1 of the ISO Tariff states:

[t]he ISO shall exercise Operational Control over the ISO Controlled Grid to meet planning and Operating Reserve criteria *no less stringent than those established by WECC and NERC* as those standards may be modified from time to time

(Emphasis added.) Section 2.5.2.1 requires that the ISO set Ancillary Services standards “*based on WECC Minimum Operating Reliability Criteria (MORC) and ISO Controlled Grid reliability requirements*” and further provides that “[t]he standards developed by the ISO shall be used as a basis *for determining the quantity* and type of each Ancillary Service which the ISO requires to be available.” (Emphasis added.)

As uncontested evidence before the arbitrator established – and as the Commission well knows – WECC criteria for maintaining reliability are applied on the basis of an entire Control Area. The phrase “consistent with WECC and NERC criteria” in Section 2.5.1 of the ISO Tariff means that the ISO must take into account Load in the ISO’s entire Control Area when procuring Ancillary Services to meet its tariff

responsibilities.²⁰ In order to maintain the reliability of one constituent part of a Control Area – for example, the ISO Controlled Grid as a constituent part of the ISO’s entire Control Area – the Control Area operator (the ISO) must ensure the reliability of the entire Control Area.²¹ In order to ensure the reliability of the entire Control Area, and thus each of its constituent parts, the ISO must back up all schedules in the Control Area with sufficient Ancillary Services.

No party contradicted the ISO’s evidence regarding the meaning of the critical phrase “consistent with WECC and NERC criteria.” Indeed, opposing parties conceded this point.²² There is no evidence in the record from which one could draw any other conclusion regarding the meaning of this phrase.

A different reading could be sustained only if the Commission were to ignore the last few words in Section 2.5.1: “consistent with WECC and NERC criteria.” Under fundamental rules of construction, all words in a law, regulation, contract – or Tariff –

²⁰ For example, under the WECC Minimum Operating Reliability Criteria, Operating Reserve (Ancillary Services) requirements are calculated as a function of Load Responsibility, which is defined as “[a] control area’s firm load demand plus those firm sales minus those firm purchases for which reserve capacity is provided by the supplier.” Exh. ISO-8, Record at 04699 (emphasis added). See *a/so*, Tr. 1208: 23-25. Under the WECC criteria, the ISO is responsible for monitoring the entire control error for frequency deviation or an area control error. Tr. 1271:6 – 1272:7. In order to respond immediately to these Control Area deviations, the ISO must have, under its control, adequate Regulation. Tr. 1280:19-22. In order to respond and restore balance following such disturbance, the ISO must maintain adequate Operating Reserves. Tr. 1277:8-1278:18. The ISO uses this Ancillary Service capacity to match deviations in the output of resources serving Loads in the ISO’s Control Area, including off-ISO Controlled Grid Loads. The WECC, and therefore ISO Tariff, Ancillary Service requirements reflect the ISO’s Load responsibility as a Control Area operator – *i.e.* the Control Area Load. Exh. ISO-8, Record at 04668-71.

²¹ Each Control Area operator maintains the reliability of its Control Area, and each of its constituent parts, so that the reliability of *the entire interconnected grid* may be maintained.

²² Even the witness for the Sacramento Municipal Utility District echoed this view when he testified that the “Control Area operator needs to satisfy itself that the Control Area has adequate reserves for all load.” Tr. 183:17-19. During most of the relevant period, all of the Intervenor operated within the ISO’s Control Area, albeit not on the ISO Controlled Grid, for the transactions at issue here. Tr. 43:15-23; 645:20-25; 678:11-16; 702:16-20; 728:8-9; 740:17-24; 769:10-20. Because the Intervenor were geographically located within the ISO’s Control Area, the ISO must ensure adequate Ancillary Services in those instances where self-provision of Ancillary Services is insufficient to ensure system reliability, in order to comply with WSCC and NERC reliability criteria.

must be considered and given effect.²³ The meaning of those final words in the sentence is straightforward: *i.e.*, the ISO is required to follow WECC and NERC criteria in procuring Ancillary Services. Those criteria require that the ISO take into account schedules that are not on the ISO Controlled Grid, but are in the ISO Control Area, in procuring Ancillary Services. This language would be mere surplusage, and the requirements of Section 2.3.1.3.1²⁴ and 2.5.2.1²⁵ would be meaningless, if the ISO could not consider off-Grid, Control Area transactions in evaluating its Ancillary Services needs.

Any interpretation of the ISO Tariff provisions that requires the ISO to turn a blind eye to off-ISO Controlled Grid Loads and other conditions not *directly* involving the ISO Controlled Grid would gravely threaten reliability. The Commission certainly recalls the genesis of the August 2003 blackout in the Northeast United States and Canada, in which the failure of transmission lines and power plants in one area initiated a cascading failure on the interconnected electrical grid, which ultimately left about 50 million people in eight states and Ontario without electricity. The ISO would be reckless

²³ In that regard, the Commission has stated:

In construing what a tariff means, certain general principles apply. One looks first to the four corners of the entire tariff, considers the entire instrument as a whole, giving effect so far as possible to every word, clause and sentence, and attributes to the words used the meaning which is generally used, understood, and accepted.

Columbia Gas Transmission Corp., 27 FERC ¶ 61,089, at 61,166 (1984), citing *United States v. Missouri-Kan.-Tex. R.R. Co.*, 194 F.2d 777, 778 (5th Cir. 1952); *Vreeland v. F.P.C.*, 528 F.2d 1343, 1351 (5th Cir. 1976).

²⁴ “The ISO shall exercise Operational Control over the ISO Controlled Grid to meet planning and Operating Reserve criteria no less stringent than those established by WECC and NERC”

²⁵ “Ancillary Service standards shall be based on WECC Minimum Operating Reliability Criteria (MORC) and ISO Controlled Grid reliability requirements. . . . The standards developed by the ISO shall be used as a basis for determining the quantity and type of each Ancillary Service which the ISO requires to be available.”

to pretend that events and conditions in or on the facilities adjacent to the ISO Controlled Grid cannot affect its reliability.

For all the foregoing reasons, the ISO renews its request that the Commission clarify that its Orders do not preclude the ISO from taking into account off-ISO Controlled Grid Schedules in setting the standards for and in procuring reliability services for the ISO Controlled Grid.

IV. CONCLUSION

WHEREFORE, for the above-stated reasons, the ISO respectfully requests that the Commission grant the request for clarifications provided above.

Respectfully submitted,

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Dated: May 18, 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 lists 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 18th day of May in the year 2005 at Folsom in the State of California.

/s/ Stephen A.S. Morrison
Stephen A.S. Morrison