UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Russell City Energy Center LLC	))	**Docket No. ER19-2800-000**

MOTION FOR LEAVE TO ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO COMMENTS

I. Introduction

The California Independent System Operator Corporation (CAISO) hereby submits this motion to answer and answer to comments pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure.[1] Russell City and the CAISO negotiated an agreement for black start service from the Russell City Energy Center (RCEC) to address a significant reliability need in the San Francisco Bay Area. No party disputes the critical significance of this need or the reliability and resilience benefits of developing black start capability at RCEC.[2]

Russell City has requested that the Commission accept the Black Start Agreement by November 6, 2019. The record of this proceeding and the public interest support Commission acceptance of this Black Start Agreement. Delay in accepting the

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[1] 18 C.F.R. §§ 385.212, 385.213. Specifically, the CAISO respectfully requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to answer certain comments filed in the proceeding. Good cause for the waiver exists because the answer addresses new assertions regarding the CAISO's Black Start Agreement with Russell City Energy Center LLC (Russell City). The CAISO's answer clarifies the record, provides additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in the case. *See e.g.*, *Equitrans, L.P.*, 134 FERC ¶ 61,250 at P 6 (2011); *Cal. Indep. Sys. Operator C*orp., 132 FERC ¶ 61,023 at P 16 (2010); *Xcel Energy Servs., Inc*., 124 FERC ¶ 61,011 at P 20 (2008).

[2] Pacific Gas and Electric Company (PG&E) and the California Public Utilities Commission (CPUC) both filed interventions and comments in this proceeding.

Black Start Agreement will likely increase the costs of installing black start capability at RCEC and delay the date on which RCEC can provide black start service. This will extend the exposure of the San Francisco Bay Area to service restoration delays in the event of a wide-spread outage, with consequential risks to public health and safety. The Commission must weigh these outcomes as it considers the comments submitted in this proceeding.

In response to Russell City's filing, the CPUC filed comments arguing it does not support the cost-of-service model for the Black Start Agreement without Russell City providing detailed cost information underlying the Black Start Agreement. The CPUC argues the Commission should require Russell City to refile the Black Start Agreement with these underlying costs. Alternatively, the CPUC requests that, if the Commission accepts the Black Start Agreement, it should find that the agreement is not precedential.[3]

The Commission should reject the CPUC's comments and accept the Black Start Agreement as filed. The Black Start Agreement is based on a cost-of-service model. Both the CAISO and PG&E evaluated the various cost components that make up this Black Start Agreement, which generally includes Engineering, Procurement, and Construction (EPC) contract cost, Russell City's project development costs, variable operations and maintenance costs, and allowance for income taxes. The CAISO discussed these general cost components with stakeholders in the CAISO's stakeholder initiative underlying its procurement efforts to secure additional black start service.[4] As

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3 CPUC Comments p. 8.

4 *See e.g.* Article III of Draft Black Start Agreement posted on June 15, 2017, available at http://www.caiso.com/Documents/BlackStart_SystemRestorationPhase2SampleAgreement.pdf.

explained in this answer, the CPUC had access to the data underlying the costs of the Black Start Agreement well in advance of Russell City's filing. More importantly, Russell City provided a sufficient showing for the Commission to accept the Black Start Agreement. The CPUC's concern that the Black Start Agreement creates some form of precedent is misplaced. The rate under the Black Start Agreement will apply only to black start service provided by Russell City based on the unique circumstances of RCEC. Finally, the public interest strongly supports issuing an order approving the agreement by November 6, 2019, to facilitate the development of black start capability at RCEC next year. Absent such an order, the San Francisco Bay Area will continue to face the risk of a prolonged loss of electric service lasting several days in the event of a system-wide outage, which can potentially harm public health and safety.

II. The Black Start Agreement between the CAISO and Russell City reflects a cost-of-service model

After completing a competitive solicitation process in 2017, the CAISO selected Russell City to provide black start service. Pursuant to its tariff, the CAISO undertook to negotiate a contract with Russell City for black start service.[5] The CAISO, Russell City, and PG&E spent considerable time and effort developing and evaluating the costs that underlie the Black Start Agreement. PG&E's financial condition and its status as a debtor-in-possession under Chapter 11 of the U.S. Bankruptcy Code delayed these negotiations and ultimately resulted in the CAISO and Russell City negotiating a two-party agreement for black start service.

In its comments, the CPUC asserts that the Black Start Agreement between the

[5] Section 5.2 of the CAISO Tariff.

CAISO and Russell City reflects a negotiated rate and Russell City has provided no underlying cost information.[6] The CPUC questions whether the Black Start Agreement is in fact based on a cost of service model, implying the CAISO has deviated from its commitment to stakeholders to secure additional black start capability in the San Francisco Bay Area based on a cost-of-service model.[7] The CPUC's comments are without merit.

The negotiated Black Start Agreement reflects a cost-of-service model to secure black start capability from RCEC. Under the Black Start Agreement, the parties identified a revenue requirement over the term of the agreement that reflects the cost of providing black start service from RCEC, including an opportunity for Russell City to earn a reasonable return on its investment. This model is by definition a cost-of-service ratemaking.[8]

The cost elements of Russell City's proposed revenue requirement follow the categories the CAISO developed and shared with stakeholders during its competitive solicitation process.[9] Using these cost categories, Russell City and the CAISO developed a revenue requirement using a bottoms-up approach based on the costs for providing black start service. These cost categories include costs of executed EPC contracts, permitting and licensing costs Russell City has already incurred, an overall

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[6] CPUC Comments at 4.

[7] *Id* at 4-6.

[8] Russell City requested the Commission grant waiver of all remaining filing requirements, including the information required by 18 C.F.R. § 35.12(b), or under 18 C.F.R. § 35.13, should the Commission consider a change in rate schedules. If necessary in the Commission's view, the CAISO urges the Commission to grant this waiver and accept the Black Start Agreement as filed.

[9] *See e.g.* Black Start Resource Commercial Worksheet/Questionnaire posted May 8, 2017, at http://www.caiso.com/Documents/BlackStart_SystemRestorationPhase2_DraftCommercialWorksheet.pdf.

project contingency and a reasonable return on Russell City's capital investment. The costs to provide black start capability also include fixed operations and maintenance costs that comprise, among other line items, ongoing services Russell City's EPC contractors will provide, insurance, plant services and testing, property taxes, as well as payments for tax liability at applicable federal and state tax rates. The CAISO has reviewed and evaluated these costs with the assistance of an independent consultant and concluded that the costs are reasonable for the black start service Russell City will provide.

The CPUC asserts the Black Start Agreement contains an asymmetrical contract provision that allows Russell City to seek recovery of additional costs under Section 205 of the Federal Power Act, if its capital investment costs or fixed operation and maintenance costs exceed those that form the basis of the costs set forth in Schedule 5 of the Black Start Agreement.[10] However, this provision does little more than memorialize Russell City's right to make such a filing under the Federal Power Act. This provision merely documents a process for Russell City to make such a filing and provide the CAISO the required time and opportunity to review and verify any such cost increases in advance of Russell City making such a filing. In no way does the provision guarantee cost recovery, nor does it intrude on the ability of the CPUC, or any other entity, to question those cost increases or, whether in the future, the rate under the parties' Black Start Agreement remains just and reasonable under section 206 of the Federal Power Act. As such, the Commission should reject the CPUC's concern that

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[10] CPUC Comments at 7-8. *See* section 3.2.1(b) of the Black Start Agreement submitted with Russell City's September 12, 2019 filing.

the Black Start Agreement creates an asymmetrical right for Russell City.

III. The CPUC has had the opportunity and time to review cost information underlying the Black Start Agreement

In its comments, the CPUC argues that Russell City did not provide sufficient transparency or time for review of the Black Start Agreement.[11] This argument is difficult to reconcile with the fact that the CAISO provided the CPUC with drafts of the Black Start Agreement and underlying cost information as the parties' negotiations progressed.[12]

In June 2019, the CAISO provided the CPUC with a draft of the Black Start Agreement, an overview of the cost and scope of Russell City's capital expenditures and operational and maintenance expenses that included line items for each cost component, as well as an inventory of data the CAISO had received from Russell City to validate these costs. In July 2019, the CAISO provided the CPUC with a copy of its consultant's report assessing the costs under the Black Start Agreement. In August 2019, after additional negotiations to address increased work required at RCEC to install black start capability, the CAISO provided the CPUC with revised overviews of the cost and scope of Russell City's fixed capital expenditure costs and operation and maintenance costs. The CAISO also provided the CPUC with an update from its consultant assessing revised capital costs. The CAISO, Russell City, and PG&E have made themselves available and answered questions on several telephone calls with

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11 CPUC Comments at 3.

12 In addition, the CPUC has had ample notice of the permitting activities Russell City undertook at the California Energy Commission, which included detailed proposals for the installation of a battery system at RCEC. *See* California Energy Center Docket Card for 01-AFC-07C, available at https://docketsearch.energy.ca.gov/Pages/results.aspx?k=*&a=IsDocument%3a1+DocketNumber%3a01-AFC-07C&docketnumber=01-AFC-07C.

representatives of the CPUC. The CPUC has had ample opportunity and time to review the costs underlying the Black Start Agreement.

IV. The record of this proceeding contains sufficient information for the Commission to accept the Black Start Agreement based on the specific terms of this transaction

Regarding the record in this proceeding, Russell City, the CAISO, and PG&E have already provided significant information and support in the record to justify acceptance of the Black Start Agreement. The Commission should recognize that the majority of costs under the Black Start Agreement involve fixed capital investment and development costs based on actual costs set forth in contracts with third parties. In addition, the Commission should recognize that the costs proposed under the Black Start Agreement are transaction-specific and reflect the installation of a battery system to support black start service at RCEC.

As explained in the CAISO's comments filed in this proceeding, the CAISO engaged the services of a consultant to assess the costs of equipment and labor required to install black start service under the Black Start Agreement.[13] The CAISO's consultant reviewed various cost components, including the costs set forth in Russell City's EPC contracts, Russell City's estimated development costs, and proposed contingency costs. The CAISO's consultant developed a bottoms-up cost estimate to assess the project costs using various sources of information to evaluate the cost of installing an integrating the battery system at RCEC to support the provision of black start service. The CAISO's consultant determined that the overall project cost falls

13 CAISO Comments pp. 8-9.

within the upper end of a reasonable cost range it developed. The CAISO provided a copy of its consultant's evaluation of the project costs to the CPUC.

In its comments, the CPUC has identified a series of specific concerns in its comments about the costs under the Black Start Agreement. The CAISO responds to each of these concerns.

- **CPUC Concern No. 1:** The filing includes some information on the capital structure (*e.g.*, 9 percent, after tax, with 100 percent equity), but does not explain why this is reasonable, given this project is in part owned by a parent corporation, subject to corporate finance rules.[14]

The CPUC's comments fail to recognize the justification provided by Russell City for the rate-of-return under the Black Start Agreement.[15] As explained in Russell City's filing, the rate-of-return that the parties have negotiated is within a similar range of rates of return the Commission has accepted for well-established generation technologies and transmission investments. In this case, however, Russell City is taking an increased risk to develop a new technology solution to meet a critical reliability need.

Under the Black Start Agreement, Russell City is investing its own funds to install black start capability at RCEC. The after-tax rate-of-return of nine percent will compensate Russell City for the commitment of its own capital solely to develop, and then operate, a battery system to support black start service at RCEC for the benefit of the CAISO system and public interest. The Black Start Agreement requires a high-level of performance from the project because the CAISO system will need black start service from RCEC during the entire five-year term of the Black Start Agreement. Additionally, the battery system at RCEC will not operate or participate in the CAISO's energy or

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14 CPUC Comments at 6.

15 *See* Russell City transmittal letter dated September 12, 2019 in ER19-2800 at 20-21.

ancillary service markets. Instead, the sole purpose of the battery system will be to support black start service from RCEC to restart the transmission system in the event of a system-wide outage, *i.e.,* a black start event, of the San Francisco Bay Area. Russell City will not have an opportunity to use the battery system for any other purpose to generate revenue. Russell City is taking the financial risk of developing this critical infrastructure. Russell City is not issuing debt or seeking to socialize the risk of project failure to others. Under these circumstances, and considering the urgency associated with meeting the need, the Commission should accept the rate-of-return under the Black Start Agreement.

- **CPUC Concern No. 2:** The filing does not indicate whether any contingencies are included, the magnitude of these contingencies and whether these contingencies are capitalized and, if so, why they should be capitalized at 9 percent return on equity, with a gross up for taxes that remain unspecified.[16]

The fixed capital investment costs under the Black Start Agreement includes an overall contingency of $1.5 million. These contingency costs address the possibility of increased EPC costs, increased development costs, and increased costs to integrate the battery system at RCEC, which Russell City will pay to outside vendors or incur itself. These cost elements are appropriately classified as fixed capital investment costs subject to a rate-of-return. As reflected in response to CPUC concern No.1, the rate-of-return under the Black Start Agreement recognizes the need for a high-level of performance over a five-year period as well as the fact that Russell City will not have an opportunity to use the battery system for other purposes to generate revenue.

[16] CPUC Comments at 6.

- **CPUC Concern No. 3:** The filing does not indicate what development costs are included and the magnitude of these developments, why they are reasonable, and why they should be capitalized at a 9 percent return on equity, with a gross up for taxes that remain unspecified.[17]

The fixed capital investment costs under the Black Start Agreement include approximately $3.3 million in development costs to address engineering, permitting, construction field management/home office support, third party consultant fees, legal, and construction insurance. A portion of these costs have already been incurred to modify RCEC's siting permit from the California Energy Commission. In addition, Russell City has spent considerable expenses to negotiate its EPC contract, the Black Start Agreement itself and work with RCEC's current lenders and PG&E to obtain consent to proceed with the project. Additional engineering work, administrative support, and insurance associated with construction and development will also contribute to these costs. The CAISO understands it is common practice to capitalize development costs associated with construction, and the Commission's regulations recognize direct and indirect development costs in connection with the construction of an electrical plant as eligible to be booked as an Electrical Plant in Service.[18]

- **CPUC Concern No. 4:** The filing does not indicate what tax rates are assumed and why these tax rates are appropriate with an all-equity structure.[19]

Russell City's revenue requirement under the Black Start Agreement reflects a federal tax rate of 21 percent and a state tax rate of approximately nine percent. These are the applicable tax rates for corporate entities within California, and the parties have

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[17] *Id.* at 7.

[18] *See* 18 C.F.R Part 101, Uniform System of Accounts, Electric Plant Instruction 3 – Components of construction cost.

[19] CPUC Comments at 7.

used them as an input into the Black Start Agreement. The Commission should accept the Black Start Agreement with these rates because they are consistent with federal and state law.

- **CPUC Concern No. 5:** The filing does not include any information on a depreciation schedule and whether straight line depreciation or accelerated depreciation is used and why, whether there is any residual value, and why five years was assumed for a project and whether contract life is appropriate for depreciation.[20]

As part of its filing, Russell City submitted an Affidavit of Jeffrey Koshkin to explain the calculation of depreciation in its accounting systems of the useful life of the battery system it will install at RCEC. As explained in Mr. Koshkin's declaration, Russell City determined the useful life of the battery system by considering the same factors that the company has applied to other depreciable assets in Calpine Corporation's fleet. Mr. Koshkin explains that the useful life of a depreciable asset is an accounting estimate of the number of years an asset is likely to remain in service for the purpose of cost-effective revenue generation. In addition, Mr. Koshkin explains the factors Russell City applied in determining the useful life of the battery system Russell City will install at RCEC. The CPUC's comments ignore this record evidence that supports the depreciation of the battery system Russell City will install at RCEC.

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20 *Id.*

- **CPUC Concern No. 6:** The filing does not include any information about operations and maintenance or administrative and general overhead costs – either the magnitude of these cost components or the magnitude and how one would determine whether they are reasonable.[21]

The fixed operation and maintenance costs under the Black Start Agreement filed by Russell City consist of annual costs between $680,000 and $755,000 over the five-year term of the Black Start Agreement that Russell City will incur itself or pay to third party contractors.[22] Russell City has described the costs these payments will address in its September 12, 2019, filing.[23] The described costs reflect cost estimates to maintain the battery system in a state of readiness, testing costs, and maintenance and operation costs. These costs include required training and compliance costs that will be incurred by Russell City to enable its employees and contractors to provide the black start service, including costs incurred to comply with the North Electric Reliability Corporation's mandatory reliability standards.

V. The public interest strongly weighs in favor of accepting the black start agreement by November 6

In addition to the record support for the Black Start Agreement in this proceeding, the public interest strongly favors accepting the Black Start Agreement. The CAISO cannot overstate the need to secure additional black start capability to improve service restoration times in the San Francisco Bay Area. Currently, the restoration times in San Francisco Bay Area could take several days in the event of a system-wide outage, *i.e.,*

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[21] *Id.*

[22] *See* Schedule 5 of the Black Start Agreement submitted with Russell City's September 12, 2019 filing. These annual fixed operation and maintenance costs escalate at a rate of 2.5% per year.

[23] *See* Transmittal letter to Russell City's Black Start Agreement filing, dated September 12, 2019 in Docket No. ER19-2800 at 11-13.

a black start event. The CPUC's comments acknowledge this need but fail to recognize the steps Russell City must take to install and commission the battery system at RCEC as soon as possible in order to provide black start service.

Under its current EPC contract, Russell City must issue a notice to proceed with construction no later than December 9, 2019, which aligns with parties receiving a Commission order on November 6, 2019, and a rehearing period of thirty (30) days. This date allows for the timely ordering of equipment and the scheduling of necessary installation work. Any delay in ordering equipment and commencing construction of the battery system will in a likelihood increase costs for Russell City to provide black start capability. In addition, under its current power purchase agreement, Russell City cannot take planned outages at RCEC during summer months. In order to install the equipment necessary to provide black start and complete commissioning of this capability, Russell City needs to utilize planned outages in the spring and fall of 2020. A delay in accepting this agreement as suggested by the CPUC will also cause delays in installation work, thereby causing a substantial delay in the commencement date under the Black Start Agreement for providing black start service to the CAISO. This is not in the public's interest.

The regulatory certainty of the Commission issuing an order by November 6, 2019 accepting the Black Start Agreement will provide time for the rehearing period to pass before Russell City provides its EPC contractor with a final notice to proceed. Without such a Commission order, the CAISO anticipates that securing black start services from RCEC will become more expensive and take longer to deploy and provide black start capability.

V. Conclusion

The Commission should reject that CPUC's concerns that Russell City has not justified the cost under the Black Start Agreement. The CPUC has had underlying cost information involving the Black Start Agreement for months. As an alternative, the CPUC proposes that, if the Commission accepts the Black Start Agreement filed by Russell City, the Commission should clarify that the agreement does not set any precedent. As explained in this answer, the Black Start Agreement between the CAISO and Russell City is based on a cost-of-service model that reflects specific details of the infrastructure at RCEC that Russell City will deploy to provide black start service. For all intents and purposes, it will not be precedential. Moreover, the record of this proceeding, and the public interest, supports the Commission's acceptance of this Black Start Agreement. Without such an order, the San Francisco Bay Area faces unacceptable service restoration delays in the event of a black start event. For all these reasons, the Commission should accept the Black Start Agreement between the CAISO and Russell City as filed.

Dated: October 10, 2019

Respectfully submitted,

By: ***/s/ Andrew Ulmer***

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CERTIFICATE OF SERVICE

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

Dated at Folsom, California, this 10th day of October, 2019.

/s/ Grace Clark
Grace Clark