

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

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

**REPLY BRIEF OF THE CALIFORNIA INDEPENDENT
SYSTEM OPERATOR CORPORATION**

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Dated: September 2, 2005

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**To: The Honorable H. Peter Young
Presiding Administrative Law Judge**

INTRODUCTION

The California Independent System Operator Corporation (“ISO”)¹ files this brief pursuant to the schedule established on the final day of the hearing in the above-captioned matter. This Reply Brief addresses the issues designated in the Joint Stipulation of Issues.

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

DISCUSSION OF ISSUES IN JOINT STIPULATION OF ISSUES

Docket No. ER04-835

I. Allocation of MLCC Costs

A. What factors should be considered in determining whether the ISO's Amendment No. 60 cost allocation proposal is just, reasonable and not unduly discriminatory?

In its Initial Brief, the ISO presented its understanding of the principles that should guide the Presiding Judge's consideration of Amendment No. 60 to the ISO Tariff. Various parties have offered similar or differing comments. In particular, a number of parties focus on the question of whether the Presiding Judge should evaluate the allocation of MLCC according to "cost causation" or "benefits received." As the ISO noted in its Initial Brief, this is not a distinction the Commission makes. Significantly, no party identifies a decision in which the Commission identified cost causation and benefits received as distinct analyses. The reason is simple. As a regulated public utility providing transmission subject to the Commission jurisdiction, the ISO must justify its costs as the cost of providing that transmission service. In other words, the ISO incurs costs to provide transmission service, *i.e.*, to provide the benefits to the users of the transmission system. Each of the users of the system causes the ISO to incur costs. Once benefits have been identified, the issue is whether the costs are being allocated with a reasonable degree of granularity, *i.e.*, whether the benefit is reasonably direct, under the circumstances. This is consistent with the most basic statement of cost causation, endorsed by the Commission and cited in the ISO's Initial Brief: "Properly designed rates should produce revenues from each class of customers, which match, *as closely as practicable*, the costs to serve each class of individual customer." *Alabama Elec. Coop., Inc. v. FERC*, 684 F. 2d 20, 27 (D.C. Cir. 1982) (emphasis

added); *see also California Indep. System Operator Corp.*, 103 FERC ¶ 61,114 at P 26 (2003).

As a general matter, the ISO believes that its Initial Brief adequately supports its position on these issues and no further comment is necessary. The State Water Project (“SWP”) and Southern Cities raise certain arguments, however, that the ISO did not address in its Initial Brief and that the ISO believes deserve mention.

This proceeding involves simply the allocation of the costs of the ISO’s Must-Offer obligation. SWP, however, appears to wish to use this proceeding as both a referendum on the last seven years of the ISO’s operation of the ISO’s markets and the ISO Controlled Grid and as a vehicle for shaping the ISO’s market redesign project (“MRTU” or Market Redesign and Technology Update). Indeed, in introductory paragraphs, SWP faults the ISO’s congestion management system and then states:

Because the current must offer regime fails the essential purpose and direction of electric restructuring, cost causation allocation of these costs is required to bring some order and efficiency into this system. Without price signals borne of cost causation allocation principles, economic efficiencies expected to have resulted from restructuring will not occur. Instead, costs may be expected to continue to grow out of control. Even with impending market redesign, the ISO has signaled that the method resulting from this case will continue to be used to allocate costs of non-market ISO acquisition of power for reliability purposes. Ex. SWP-49 at 31-32 (“In cases where capacity was procured by the CAISO due to cover contingencies or circumstances that were not factored into locational requirements set by the CAISO, these cost[s] could be allocated based on the LSE’s serving load in the area(s) affected by contingencies or circumstances that give rise to these additional capacity needs. For example, the cost allocation approach being developed as part of Amendment 60 any subsequent settlement could provide a basis for allocation of these costs between LSE’s.” Bodine TR 779:12-19.

SWP Br. at 5. Not only is the portion of SWP-49 discussing the allocation of only a small portion (*i.e.*, a residual cost) of the allocation of non-market acquisition of capacity

(not power) for reliability purposes, and not only does SWP turn three “coulds” (including Ms. Bodine’s) and a “for example” into a “will,” but the simple fact is that the allocation of the described costs will be, and is being, determined in the MRTU proceeding – completely independently of the results here.

The flawed conflation of the pre- and post-MRTU ISO characterizes SWP’s citation of precedent. SWP relies heavily on *Devon Power LLC*, 107 FERC ¶ 61,240 (2004) for the proposition that the Commission directed the ISO New England to develop more granular pricing signals in order to protect against subsidization in its locational installed capacity program. SWP Br. at 8-9. Actually, *Devon* was not that simple. It concerned the implementation of a locational installed capacity (“LICAP”) program as directed by the Commission and the designation of installed capacity (“ICAP”) regions, as well as the relationship of ICAP regions to energy load zones. 107 FERC ¶ 61,240 at PP 1-2. The Commission did not direct ISO New England to develop more granular pricing signal, but rejected and set for hearing the proposal for a single ICAP region for Connecticut, directed ISO New England to investigate whether an ICAP region was necessary for Southwest Connecticut, and initiated a Section 206 investigation on whether an energy load zone should be implemented for Southwest Connecticut to correspond with the ICAP region. *Id.*, Ordering paragraphs (C), (D). Subsequently ISO New England determined a separate ICAP region was necessary, presenting a detailed and complex analysis.² Over protests, the Commission subsequently approved the region. 109 FERC ¶ 61,156 at 25.

² The Commission noted:

Specifically, ISO-NE's July 2 Filing evaluated the amount of capacity

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

The Commission observed:

Addressing the energy load zone issue raised by the June 2 Order, the ISO-NE states that a separate energy load zone must be created for SWCT if a SWCT ICAP region is created. It states that if energy zones are

available in different sub-regions and the amount of capacity that could be imported and calculated estimated capacity prices to provide a basis of comparison between the regions. The analysis used scenarios for Connecticut as a whole, SWCT and a "Rest of Connecticut" ICAP region (comprising the remaining portion of Connecticut if SWCT were carved out). Using regional planning criteria for loss of load probability of one day in ten years, ISO-NE determined the capacity requirements for each region and then calculated the amount of capacity that must be located within each region (local sourcing requirement), taking into account transmission constraints while maintaining the one day in ten year criteria.

...

...

The result of this analysis, according to ISO-NE, shows that under the more restrictive "at criteria" assumptions, SWCT is deficient in capacity (i.e., it fails to meet the one day in ten loss of load probability requirement) compared to the rest of Connecticut

ISO-NE also presents an analysis showing the price differences between SWCT and the rest of Connecticut under a range of assumptions for the transfer limits and the demand curve. The ISO developed indicative regional clearing prices for all of Connecticut, SWCT, and Connecticut with SWCT excluded. . . .

ISO-NE also presents a discussion of the transmission projects planned for SWCT and southern New England. The ISO states that establishing a SWCT ICAP region will properly price the value of capacity in SWCT and should help justify and expedite the essential transmission projects underway in that area.

Devon Power, LLC, 109 FERC ¶ 61,156 at PP 10-14 (2004) (footnotes omitted).

larger than ICAP regions, contracting would be complicated for load serving entities because they would have to enter into different combinations of contracts to serve load, leading to reduced market liquidity. *ISO-NE also notes that different zones would require a costly and time-consuming redesign of the ISO settlement system. ISO-NE recommends establishing a separate energy zone for SWCT simultaneously with, and not before, the implementation of establishing a separate ICAP region for SWCT. First, ISO-NE states that, as a practical matter, it could not implement a separate SWCT energy zone much before implementation of a SWCT ICAP region. ISO-NE also notes that the earliest that a separate energy zone could be implemented would be late summer or early fall of 2005, which is only a few months before the required LICAP implementation date of January 1, 2006. Additionally, ISO-NE references its report on nodal pricing, stating that current energy price differentials alone do not justify establishing a separate SWCT energy zone at the present time if a separate ICAP region is not also created.*

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

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

Id. at P 38.

This is why SWP's continued citations of *Devon*, and of the ISO's MRTU decisions are inapt. SWP wants to put the new pricing structures in place before the new management and settlement structure that should accompany them. Amendment 60 meets cost causation principles in a manner that fits the ISO's *current* Zonal structure and is appropriate.

The ISO also believes it would be a mistake to focus the cost allocation of MLCC almost exclusively on providing incentives for transmission improvements, as Southern Cities seem to suggest. Although such incentives are a factor in the ISO's proposed

allocation of Local MLCC (consistent with the allocation of RMR costs), the allocation of Local MLCC is also consistent with cost causation, because the Participating TO will presumably pass through the costs according to such principles. As has been noted repeatedly in this proceeding, the Must-Offer requirement terminates with MRTU, which is currently scheduled for implementation in February of 2007. Any incentives provided during the remaining life of the Must-Offer requirement are unlikely to encourage significant transmission improvements, and there is no certainty that the same entities would be provided the same incentives under MRTU.

Finally, and somewhat related to the first point above, despite the efforts of SWP and some others to turn this proceeding into a referendum on the ISO's use of Must-Offer waiver denials, that is not the issue. This proceeding is about cost allocation, not about how to use transparency or incentives in order to change the ISO's operations. The Commission has so informed SWP in ruling on the ISO's compliance filing earlier in this docket:

Powerex and SWP state that it appears the CAISO is using must-offer generators to manage inter-zonal congestion rather than its existing congestion management procedure. SWP claims the use of must-offer generation emerged in testimony and discovery in the cost allocation phase of this proceeding. . . .

SWP contends that the Operating Procedure does not provide sufficient information to enable market participants to understand how and why non-market, reliability-related costs are incurred or even allocated. SWP states that the supplemental filing is insufficient because it raises some of the same questions requested in discovery. SWP contends that the Commission should require full transparency of the must-offer process to determine the reasonableness of minimum load costs incurred.

The Commission finds that the CAISO has complied with the directive of the July 8 Order by submitting Operating Procedures that explains the CAISO's capacity procurement target and when it commits generating units through the must-offer obligation. Our review indicates that the

CAISO has adequately provided market participants with detailed information to further understand the reliability needs driving the must-offer obligation process. . . .

We note that the allegations of utilizing must-offer generators to manage inter-zonal congestion rather than the existing congestion management procedure are outside the scope of this proceeding.

California Indep. System Operator Corp., 109 FERC ¶ 61,097 at PP 36-39.

B. Whether it is just and reasonable to classify MLCC costs into three buckets: System, Local, and Zonal.

No participant in this proceeding objects to the use of a three-bucket structure for the allocation of MLCC costs *per se*, but several use this topic to reiterate arguments more properly contained in other sections of their initial briefs. See, e.g., Powerex at 24, Southern Cities at 18, and SWP at 21. The ISO will address these issues under their appropriate headings. As noted in the ISO's Initial Brief, while there are perhaps other classifications of MLCC costs that could be considered acceptable, the ISO's proposal is itself just and reasonable. ISO Br. at 14.

C. Should MLCC costs be allocated, pursuant to the criteria used by the ISO to classify units committed under the Must Offer Wavier Denial (MOWD) process as set forth in Attachment E of the ISO's filing of May 11, 2004, to each of the Local, System, Zonal categories, or should they be allocated in another manner or to other categories?

For the reasons set forth in the ISO's Initial Brief, the ISO's Attachment E criteria, as modified to include the additional constraints of the South of Lugo transmission path and the Miguel Substation transformer bank in the Zonal category, are just and reasonable because they assign the costs of MLCC committed to resolve a particular category of reliability concerns to those entities that cause or are benefiting from the resolution of that category of reliability concern, consistent with cost causation principles

articulated by the Commission. ISO Br. at 15. The initial briefs of the other participants present various reasons why certain constraints should or should not be included in certain buckets, as well as alternative means of allocating the costs attributable to a given bucket. None of those reasons establish that the ISO's proposal is unjust or unreasonable.

1. Zonal Issues

a) Southern Cities Position

Southern Cities argue that the SCIT nomogram is the only constraint that should be classified as Zonal, Southern Cities at 19, presenting six purported bases for its restrictive view of the Zonal bucket: (1) Zonal and Local constraints are both caused by insufficient local generation and inadequate transmission infrastructure; (2) all constraints except SCIT must be mitigated with units that are proximate to the constraint; (3) the ISO has not demonstrated that alleviating the constraints it has categorized as Zonal provides a greater regional benefit than alleviating the constraints it has categorized as Local; (4) costs of alleviating constraints caused by a shortage of voltage support must be allocated locally; (5) the lack of RMR resources is the cause of most Zonal MLCC costs, and RMR costs are allocated locally; and (6) the criteria used by the ISO in determining which constraints should be considered Zonal are vague. Southern Cities Br. at 20; Exh. SOC-1 at 10-11. The ISO discussed Southern Cities' proximity, vagueness, and voltage support bases for excluding constraints from the Zonal classification in the ISO Initial Brief, ISO Br. at 22-24, and will discuss the remaining arguments seriatim herein.

(i) The Causes of Zonal and Local MOWDs Are Not the Same.

To state that both Local and Zonal MOWDs are caused by insufficient local generation and inadequate transmission infrastructure is meaningless. It certainly does not imply that alleviating such constraints is thus solely within the power of the local Participating TO. The transmission constraints, *i.e.*, inadequate transmission infrastructure, that give rise to local MLCC are, by definition, local. They reflect constraints in the area of a single Participating TO. In Zonal MLCC they are by definition Inter-Zonal Interfaces, or in the proposed cases of South of Lugo and Miguel, affect more than one Participating TO. They thus do not reflect local inadequate transmission infrastructure. Lack of Generation is not the source of the constraint. Indeed, the purpose of the MOWD is to bring existing unused Generating Units online to compensate for the constraint.

Even if Southern Cities' argument is that more efficient, less expensive Generation is needed in order to reduce imports into a Zone or locality, the comparison does not work. With Local MLCC, the Generating Unit would need to be within the Load pocket; with Zonal MLCC, it would only need be within the Zone. As described in the testimony of Jim McIntosh, "Under the ISO's current Congestion Management model, all Generating Units within a Congestion Zone are considered to be equally effective at managing flows on the Inter-Zonal Interface." Exh. ISO-22 at 22.³ Zones include more than one Participating TO.

³ As noted in the ISO's Initial Brief, the ISO's market design is undergoing a major revision in the form of MRTU (scheduled to be implemented in February 2007). ISO Br. at 5. Until that time, however, the ISO must continue to operate within its existing paradigm – including zonal management of flows.

(ii) Alleviating Zonal Constraints provides a Greater Regional Benefit than Alleviating Local Constraints.

Contrary to Southern Cities' argument, there is record evidence that alleviating the constraints that the ISO has classified as Zonal *does* provide a greater regional benefit than do those classified as Local. As noted by SCE witness Hansen, the South of Lugo and Miguel constraints, for example, are appropriately designated as Zonal because mitigating them provides "benefits to the entire SP-15 congestion zone." Exh. SCE-1 at 8-9; SCE Br. at 16. SCE also demonstrates that "The loads of multiple PTOs, not just SCE in the case of South of Lugo or SDG&E in the case of Miguel, are served directly from and thus derive benefits from these paths." SCE Br. at 17; Exh. SCE-6 at 10:20-21. With regard to the constraints that fall under the original Attachment E criteria, *i.e.*, those involving Inter-Zonal Interfaces, Mr. Hansen explains that "all interzonal interface constraints by definition do benefit the load within the entire zone." Exh. SCE-1 at 8:17-18.

(iii) Zonal MLCC Costs Are Not Parallel to RMR Costs

Finally, Southern Cities' RMR arguments are simply irrelevant to this proceeding. RMR Units are designated as such by the ISO in the Local Area Reliability Study ("LARS") process, and the costs related to them are allocated pursuant to RMR Contracts. Tr. 846-51 (Bodine). MOWD units may be any non-hydro unit in the ISO Control Area at any given time, based on the circumstances. ISO Tariff Section 5.11.1 (Item by Reference 1, sheet 184A). That some units recently denied must offer waivers may have previously been designated as RMR Units does not mean that these units are

being dispatched pursuant to must offer for the same purposes that they formerly were for RMR. Tr. 1051:8-17 (McCann).

Moreover, RMR costs are local costs. Tr. 461:11-14 (McIntosh); Tr. 710; 846:24 – 847:1 (Bodine). Southern Cities' attempt to use an RMR/MOWD equivalency argument to demonstrate that the constraints the ISO has classified as Zonal should really be classified as Local. Southern Cities Br. at 24-25. In general, RMR was designed to be resource for local issues, and was never intended to alleviate constraints on Inter-Zonal Interfaces, which form the majority of constraints classified as Zonal under the ISO's proposal. See, e.g., *AES Southland, Inc.*, 94 FERC ¶ 61,249 at 61,873 (2001). Further, in the specific cases of South of Lugo and Miguel, both of these constraints are associated with 500 kV paths. The Miguel substation is the western terminus of the 500-kV Southwest Power Link (Exh. ISO-22 at 23:20), and the South of Lugo path is made up of three 500-kV circuits from Lugo substation to the south. *Id.* at 25:8-9; Tr. 501:1-2 (McIntosh). As the record demonstrates, RMR criteria do not provide for addressing constraints on lines of 500 kV or above (Tr. 500 (McIntosh); Exh. SOC-3 at 137), so any attempt to demonstrate equivalency between RMR and MOWDs with regard to these constraints must fail.

Even assuming there is a relationship between the number of units designated as RMR and the level of MLCC costs related to MOWDs, this proceeding is about whether the ISO's proposed allocation of MLCC costs is just and reasonable, and not whether the ISO should have designated additional RMR Units in SP15. If Southern

Cities believes that the ISO is improperly using the Must-Offer process as a substitute for RMR, it should pursue that matter separately.⁴

b) Commission Staff Position

The Commission Trial Staff supports the ISO's classification proposal (as reflected in the ISO's testimony) apart from the appropriate treatment of the South of Lugo constraint. Although the ISO has argued that this constraint should be moved from the Local bucket (where it would be placed under the Attachment E criteria) to the Zonal bucket, Staff witness Gross believes it should remain in the Local bucket. Exh. S-6 at 28:1 – 30:18; because (1) the constraint is largely due to voltage stability problems (Staff Br. at 19-21); (2) the generation effective in alleviating the constraint is largely in the territory of a single Participating TO (Staff Br. at 21); (3) the ISO's operation of the grid indicates that the constraint is localized (Staff Br. at 23); and (4) the ISO's operating procedure related to the constraint indicates its local character. Staff Br. at 24.

With regard to Staff's voltage stability arguments, the ISO explained in its Initial Brief that denying waivers for purposes of making units available to provide Voltage Support with regard to a given Zonal constraint provides benefits to the system beyond a local area (Tr. 457-58 (McIntosh)), and therefore the costs related to such denials are appropriately assessed on a Zonal basis. ISO Br. at 23-24.

Moreover, all of Mr. Gross's arguments as to the nature of South of Lugo are seriously undermined by his continued reliance on an outdated ISO operating

⁴ Of course, the ISO's allocation of Local MLCC costs already tracks the RMR allocation methodology, in the sense that Local MLCC costs are allocated to the relevant Participating TO. Exh. ISO-22 at 27; Tr. 460. The parallel between RMR and Local MLCC is also the case with regard to the "incremental cost of Local" proposal discussed in Section I(D), below. Tr. 710-11; 858:22-859:1 (Bodine).

procedure, T-144 Version 4.3 (Exh. S-16). As the evidence at the hearing clearly demonstrates, this operating procedure was updated in significant ways subsequent to the filing of Mr. Gross's pre-filed testimony. Tr. 1562-63 (Gross). That Mr. Gross appears to have continued to rely on outdated information on such matters as the entities affected by the procedure (Tr. 1581-82), the load to be dropped under the procedure (Tr. 1579), and units effective in alleviating the constraint (Tr. 1586-89) is curious. Nonetheless, the fact remains the under the current version of T-144 (4.5), included in the record as Exh. S-38, the characteristics of South of Lugo Mr. Gross found to be indicative of its Local nature are not present. Instead, the Zonal nature of this constraint becomes clear.

c) PG&E Position

PG&E frankly states that it only takes a position as to whether the South of Lugo constraint is classified as Zonal or Local to the extent the "incremental cost of local" proposal (discussed below in Section I(D) of this brief) is adopted by the Commission. PG&E at 9-10. Such an outcome-determined position does not merit consideration.

2. System Issues

Powerex objects to the allocation of System MLCC based on Net Negative Uninstructed Deviations ("NNUD"). Powerex Br. at 12.⁵ Powerex argues that, in particular, deviations from interchange Schedules should not be assessed for these

⁵ Powerex's alternative proposal is discussed in Section I(K) of the ISO's Initial Brief.

costs, because, in Powerex's view, "the CAISO does not take these deviations into account when deciding whether or not to deny must-offer waivers." *Id.*⁶

It is certainly true that the ISO cannot take into account the actual deviations from Schedules (interchange or otherwise) in determining the must-offer waivers to deny. It could not be otherwise, since waivers are denied before actual deviations are known. Tr. 542-543 (McIntosh). As acknowledged by Powerex, System MOWD decisions are based on when the ISO expects Demand to exceed Supply in the ISO Control Area. Powerex Br. at 13. What Powerex fails to grasp is that, since Scheduling Coordinators are required to submit Schedules in which Demand and Supply are equal (*i.e.*, balanced Schedules), it is completely appropriate that when Demand exceeds Supply those entities that deviated from balanced Schedules should pay the costs of making up the difference. Tr. 534:15-20 (McIntosh). Interchange Schedules are no different in this regard. Tr. 531:4-8 (McIntosh).

Finally, Powerex contends that, since Scheduling Coordinators that deviate from Schedules already pay the costs of replacement energy, they should not also have to pay for the MLCC costs. Powerex Br. at 18. This is another instance of conflating Energy with capacity, similar to that discussed in Section IV of this brief and the ISO's Initial Brief with regard to Ancillary Services. The must-offer obligation requires generators to offer capacity into the ISO's Real Time Market. See ISO Tariff Section 5.11.4 (Item by Reference 1 at Sheet 184B). MOWDs thus are made to ensure sufficient capacity is available, and thus allocating their costs to those whose Schedule

⁶ Powerex's additional arguments on this topic were discussed in the ISO's Initial Brief.

deviations make them necessary is not duplicative of assessing Energy costs to these entities.

D. Whether the “incremental cost of Local” approach for determining the allocation of MLCC costs between “System” and “Local” categories is just and reasonable.

PG&E opposes the “incremental cost of Local” allocation methodology because, according to PG&E, 1) it only benefits SCE, and 2) it mutes appropriate price signals. PG&E Initial Br. at 10. PG&E also criticizes the origin of this provision, in that it initially was suggested in the stakeholder process by SCE. *Id.* PG&E goes so far as to suggest some kind of impropriety on the part of the ISO in accepting SCE’s suggestion. *Id.*

The ISO described the intention behind the incremental local allocation methodology in its Initial Brief at 26-28, and will not belabor that argument here. Suffice it to say that this methodology is just and reasonable and consistent with the cost causation/benefits received criteria described in Section I(A) of the ISO’s Initial Brief.⁷

That SCE currently is the beneficiary of this mechanism is not determinative of whether it is just and reasonable. As noted by ISO witness Bodine, other Participating TOs such as PG&E could well benefit from this mechanism in the future. Tr. 844:22 – 845:2.

The ISO must take exception to PG&E’s aspersions as to the origins of this methodology. That a stakeholder should suggest an allocation methodology in the context of a stakeholder process created for the very purpose of soliciting stakeholder

⁷ As Staff notes in its Initial Brief: “under the incremental approach, the ISO simply charges the cost of a local Must-Offer unit that resolves a local and a system problem to the affected local PTO and to the system bucket. This sharing of the costs is consistent with the standards of cost causation and benefits received. . . .” Staff Br. at 32.

input is in no manner inappropriate. Quite the contrary – it would be improper for the ISO to fail to adopt an allocation mechanism suggested by a stakeholder that the ISO found useful and consistent with cost causation. Indeed, the entire Amendment No. 60 process arose because of stakeholder comments.

As for the alleged muting of economic incentives, the ISO has discussed the limited role incentives can play in an allocation methodology destined for such a brief existence in Section I(A), above. The most significant concern with regard to the allocation methodology at this point is that it be consistent with cost causation/benefits received – a test that the incremental cost of Local mechanism meets.

E. Timing Issues

1. Whether non-Local MLCC costs should be allocated on a daily or monthly basis.

The ISO has no reply argument on this issue.

2. Whether non-Local MLCC costs should be assessed only to loads occurring in the peak time periods for which Must Offer Waivers are denied.

SWP argues that MLCC costs are incurred to meet on-peak needs, and thus should be allocated to on-peak load. SWP Br. at 26. SWP places excessive reliance on ISO statements regarding the *majority* of MLCC costs being incurred for peak needs, and that *typically* off-peak MLCC costs are related to on-peak needs, for the faulty premise that *all* MLCC costs are incurred for on-peak needs.⁸

⁸ Citing Exh. SWP-5D, SWP contends that the ISO stated it anticipates “*no* ‘situation in which MLCC will be incurred to meet off-peak needs’ after January 2005.” SWP Br. at 27. The word “no” is the ISO’s, although the italics are SWP’s. Moreover, the quoted portion is not the ISO’s statement, but SWP’s question. As a finishing touch, SWP leaves out the remainder of the ISO’s response, which reads in *toto*, “No, though

SWP dismisses as not “credible” (SWP Br. at 27) the testimony of ISO witness McIntosh describing and/or acknowledging various off-peak MOWD needs resulting in off-peak MLCC costs that are attributable to off-peak needs. See, e.g., Tr. 574:15 – 575:3. SWP states that Mr. McIntosh was “induced” to contradict his pre-filed testimony on cross-examination, in that he would, on reflection, strike the word “only” from his pre-filed statement: “Minimum Load costs are incurred during off-peak hours only because, due to Generating Unit minimum run time requirements, it is not possible to shut the unit off for the off-peak hours and turn it on again when it is required during the on-peak hours.” Exh. ISO-21 at 6:2-5 (emphasis added).

SWP’s argument misses the point. The relevant question is not “during which hours are MLCC costs incurred?” In truth, all MLCC is incurred because it is not possible to turn a unit off for the hours when it is not needed. The relevant question from a cost causation perspective is “during which hours might the problem for which MLCC is incurred arise?” Thus, removing the word “only” does no violence to the point Mr. McIntosh was making in that part of his testimony, which already indicates that “*most* dispatches of must-offer resources occur during peak periods.” *Id.* at 6:1-2 (emphasis added).⁹ In other words, the problems most often arise during peak hours, but may arise at other times.

At the hearing, ISO witness McIntosh described many examples of situations in which the ISO would need to deny waivers for the purpose of using Must-Offer

the ISO notes that it is always possible that such a situation could arise due to an unforeseen transmission or generation outage.” Exh. SWP-5D at 2. SWP has cited no follow-up to this September 29, 2004 data response.

⁹ Of course, must-offer resources are dispatched when they are needed; MLCC costs are incurred to keep the units ready until they are needed.

Generators in non-peak periods. For example, large contingency events, such as the loss of large Generating Units, or fires could cause such a non-peak need. Tr. 389-90. In addition, planned outages such as those necessary for scheduled line maintenance could result in non-peak must offer costs. Tr. 393.

Mr. McIntosh also explained that if the issues creating the need for Must-Offer Generators to be dispatched in the off-peak were not addressed, off-peak loads (such as pump loads) would be affected. Tr. 392. Since off-peak loads benefit from MOWDs, it is clear that assessing off-peak loads a share of the costs of MLCC is just and reasonable.

SWP's contention that an ISO operating procedure dictates that the "actual driver of must offer waiver decisions is the single forecasted peak hour" (SWP Br. at 29-30) is likewise misleading. As noted by ISO witness McIntosh, examination of peak load forecast under Operating Procedure M-432C "just determines our maximum needs – the final incremental capacity. If we conclude that we need X MW of additional capacity for the peak hour, we still need X-Y MW of additional capacity for the hour before and the hour after the peak." Exh. ISO-21 at 7-8.

SWP also argues that assessing non-peak load a share of MLCC fails to send appropriate price signals, missing an opportunity to provide the incentive to loads to move to the off-peak. As described in the ISO's Initial Brief, in the short term at least, the only entities that are likely to respond to such price signals are SWP's pump loads, which have already done so. ISO Br. at 32. Thus, incentives can play a limited role in a cost allocation mechanism soon to be rendered obsolete by the ISO's move to MRTU.¹⁰

¹⁰ Indeed, the very case cited by SWP (SWP Br. at 31) as evidence of "Commission

Again, the ISO wishes to stress that it does not contend that a time-differentiated rate would be unjust or unreasonable. The ISO's only position is that time-differentiated pricing is not a prerequisite to a just and reasonable allocation of MLCC.

3. If non-Local MLCC costs should be allocated only to loads occurring in the peak time periods for which Must Offer Waivers are denied, how should the peak period be defined?

The ISO has no reply argument on this issue.

F. Whether ETC Schedules should be exempted from all or some Zonal MLCC costs.

SWP and PG&E contend that Existing Contract Schedules should be exempt from Zonal MLCC when a unit is committed to combat potential real time Inter-Zonal Congestion. Both parties' arguments are based on the assertion that Existing Contracts are exempt from ISO Congestion charges. In its Initial Brief, the ISO explained that Zonal MLCC charges are not Congestion charges.

SWP challenges this assertion as "not comport[ing] with the pertinent language contained in the ISO Tariff." It asserts that the ISO's witness's assertions cannot "trump its own official, filed tariff language," and that the ISO "seeks to establish a position different from that contained in its tariff." SWP Br. at 41. Strangely, SWP never identifies a tariff provision that equates MLCC with Inter-Zonal Congestion charges. All it can point to is the inability of the ISO's witnesses to identify a tariff provision that distinguishes the two and its assertion that the Commission has interpreted the ISO Tariff to prohibit the ISO from charging Existing Contracts "congestion charges of *any*

directives promoting demand response" concerns the ISO's market redesign, where crafting appropriate incentives for Market Participants is very much a consideration. *California Independent System Operator Corp.*, 105 FERC ¶ 61,140 (2003).

kind except in the circumstances” concerning conversion or termination of contract rights.” *Id.* (Emphasis added by SWP.)

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

The Commission language to which SWP refers appears in an order approving the ISO’s creation of a new Zone. *California Indep. System Operator Corp.*, 89 FERC ¶ 61,229 at 61,681-82 (1999). Certain parties with Existing Contracts wished confirmed that their exemption from Usage Charges would apply to Usage Charges between the new Zone and the existing Zones. *Id.* The Commission’s reference to “any congestion charges” must be read in the context of that request.

The real issue regarding Existing Contracts is best illustrated by SWP’s and SCE’s different uses of Opinion No. 459. SCE correctly notes that Opinion No. 459 rules that Existing Contract customers benefit from Reliability Services, and should share in the costs thereof. SCE Br. at 3-4. SWP correctly notes that the Commission

also concludes that the costs of Reliability Services were already included in the Existing Contracts, so that PG&E could not pass those costs through as an additional cost to Existing Contract customers. SWP Br. at 38. In contrast, in *Pacific Gas and Electric Company*, Opinion No 477, 109 FERC ¶ 61,093 (2004), PP 54-65, the Commission ruled that PG&E's Scheduling Coordinator Services are new services, the costs of which PG&E *can* pass through to Existing Contract customers. The question, therefore, is whether the services provided through Zonal MOWDs are the same protection against Congestion costs that are provided under Existing Contracts. They are not.

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

The Existing Contracts do not, however, provide that the ISO will ensure that there will be units available online to ensure that adequate capacity will remain on the Inter-Zonal Interface to ensure that the Existing Contract schedules can be fulfilled. Indeed, the contracts could not, because the ISO did not exist. The situation is not unlike that in PG&E's Scheduling Coordinator Services Tariff, where the Existing Rightsholders contended that they could not be charged for PG&E's additional Ancillary

Services costs attributable to their Schedules because they self-provided Ancillary Services under their schedules. The Commission responded:

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

109 FERC ¶ 61,093 at P 66 (quoting the Initial Decision). So too, the reliability benefits of the protection against real-time Inter-Zonal Congestion provided by the Must Offer generation is not the same scheduling priority provided by Existing Contracts, and parties to Existing Contracts need not be excused from an allocation of the costs of those benefits.

G. Whether Wheel-through schedules should be exempted from all or some System MLCC costs.

The ISO has no reply argument on this issue.

H. Whether Pump Loads should be exempted from all or some MLCC costs.

SWP contends that its pump load should be exempt from some of all Zonal MLCC costs. SWP begins its Brief by stressing the uniqueness of its role in managing water resources. Although the ISO does not believe that SWP's performance of this role is particularly relevant to the allocation of Must-Offer costs, the ISO does believe it appropriate to provide some additional perspective on SWP's comments.

Citing *California Department of Water Resources v. FERC*, 341 F.3d 906 (9th Cir. 2003), SWP first points out that, “[u]nlike private companies selling power on the wholesale markets, known as market generators, the SWP generators (and curtailable load) is dedicated to the purpose of storing and delivering water throughout California.”

SWP Br. 2. The Court goes on to note, however:

DWR operates the water system so that its electricity consumption and generation are complementary, consuming electricity to pump water during off-peak hours to allow water delivery and electricity generation during periods of peak electricity demand. DWR consumes much of the electricity it generates. It sells its surplus electricity on the ISO's wholesale markets to the extent that its water-management responsibilities permit.

Id. at 908. Of course, if indeed SWP is pumping off-peak and generating on-peak (as it must if it is to minimize Energy costs and maximize profits), it cannot be consuming all that much of its own Generation and must be selling a significant part as surplus. If one considers that SWP has close to 2000 MW of hydroelectric generation, *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.*, 112 FERC ¶ 61,024 (2005) at P 13, it becomes apparent that SWP is not only moving water, but is also a major player in the ISO's Energy and Ancillary Services markets.

Second, SWP discusses the challenges it faces beyond those faced by other Generators, citing the Commission's statement in *San Diego Gas & Electric. Co. v. Sellers of Energy and Ancillary Services, et al.*, 107 FERC ¶ 61,294 at P 8 (2004), that changes to its scheduled outages could be disruptive of its primary mission. SWP neglects to include the subsequent history of its citation, however. In an order granting rehearing, the Commission refused to give SWP the complete dispensation from ISO outage procedures that it sought based on its water responsibilities. The Commission

subjected SWP's Generating Units to the ISO's outage coordination procedures and authorized the ISO to change SWP's scheduled outages as necessary for system reliability (but not for economic reasons), with one restriction: if the change would cause SWP to violate any law affecting hydroelectric operations (such as minimum and maximum dam reservoir levels and instream flow levels) or compromise SWP's ability to deliver water to its customers, then the CAISO must first use every other option at its disposal to avoid a reliability problem before rejecting an outage request or requiring SWP to cancel any approved outage. *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.*, 112 FERC ¶ 61,024 at P 29.

SWP offers two bases for exempting its pumps from all or a portion of the MLCC. First, SWP contends that its pumps do not cause certain zonal MLCC and the ISO is capable of charging zonal MLCC with a granularity that excludes SWP's pumps. Second, SWP asserts that its pumps do not benefit from MOWDs because they are curtailable or interruptible loads used as a reliability resource. Neither of these arguments withstand scrutiny.

1. Zonal MLCC Need Not Be Allocated at the Level of Granularity that Would Exempt SWP Pump Loads in Order to Be Just and Reasonable.

As a general matter, the ISO does not take issue with SWP's factual assertions with regard to the impact of its pumps on certain Zonal constraints and on the ISO's ability to receive settlement data on a Load Group basis. It is with the conclusions that SWP draws from those facts that the ISO disagrees. The ISO has already explained in its Initial Brief the benefits that SWP's pump loads receive from Zonal MLCC, which the ISO believes are sufficient to justify SWP's payment of a pro rata portion of Zonal

MLCC. The ISO also explained the difficulty of implementing a more granular allocation under the ISO's current settlement system.

SWP, however, points to the Commission's recent order regarding the ISO's market redesign, MRTU, in which the Commission directed the ISO to provide each wholesale customer the option of establishing, as a separate zone, the set of nodes where it receives energy. SWP Br. at 44, citing *California Indep. System Operator Corp.*, 112 FERC ¶ 61,013 (2005) at P 37. As an initial matter, it should be noted that, in the MRTU order, the Commission was authorizing the ISO to implement a zonal, rather than a more granular nodal, pricing system based on various practicalities. *Id.* Moreover, the Commission was essentially writing on a *tabula rasa*, directing the ISO regarding the capabilities to build into new software that was being developed, not directing it to impose a manual override on an existing system. While it is true that the ISO will implement new settlement software in the first half of 2006 that could accommodate settlement at the subzonal level, revising the allocation of MLCC yet another time, while the ISO is working toward the elimination of the Must Offer requirement through MRTU, when such revision is not necessary to achieve a just and reasonable rate is not a wise expenditure of resources.

Moreover, SWP's proposal poses other practical problems. First, it is not clear from the evidence how many, if any, other Market Participants could schedule and meter their Loads to take advantage of this proposal. As such, it could be considered discriminatory. Second, the MRTU order SWP cites concerned Load Aggregation Points for the pricing of Demand Bids. *Id.* at P 34. These prices are established by market mechanisms for each point. In contrast, the allocation of MLCC is specifically

set forth in Attachment E, and under SWP's proposal would be specified according to constraint. The number and nature of Zonal constraints, however, is not static. If, as the ISO expects and SWP recommends, Attachment E is to be part of the ISO Tariff, the ISO would need to file a new tariff amendment to establish the allocation of each new constraint, rely on a "default", or ignore potential "cost causation" consequences of any new constraints. Until the ISO implements through MRTU a more efficient manner to ensure the commitment of adequate Generation to address reliability concerns, the allocation of Zonal MLCC on a Zonal basis is simply the fairest and most practical manner in which to proceed.

2. SWP's Assertion that Its Pumps Do Not Benefit from MOWD Because They Are Curtailable or Interruptible Loads Used As a Reliability Resource Is Meritless.

SWP states that the ISO's administration of the the ISO Controlled Grid:

has resulted in more frequent load interruptions, which, as described below, would adversely impact SWP loads before and to a greater extent than other, firm loads.

Indeed, because SWP pump loads are regularly dropped in order to protect other, firm loads, the reliability benefit—defined as protection against curtailment against firm loads—is not available to SWP.

SWP Br. at 52 (citations omitted). These contentions are, quite simply, factually unsustainable.

The facts are these. (1) The ISO has no authority to direct that SWP pump loads be involuntarily interrupted or curtailed. Tr. 280:3-6. (2) The only circumstance in which the ISO will direct that SWP pump loads will be interrupted or curtailed is if SWP voluntarily bids those loads into the ISO's markets or pursuant to a Remedial Action Scheme in an agreement with the ISO or a Participating TO. *Id.* See Exh. SWP-22L at

3, cited at SWP Br. at 56. (3) The ISO has not directed that SWP pump loads be involuntarily interrupted or curtailed since the beginning of the must-offer obligation. Tr at 396:15-18. (4) SWP's pumps are set to trip at a higher frequency in the event of a frequency disturbance. This is an automatic action, not one undertaken by the ISO. Tr at 397:9 - 398:15.

In part, SWP's argues that because ISO personnel, including some at the managerial level, would prefer the SWP Load be interruptible, SWP Br. at 53, 56, and because SCE's transmission plan mistakenly treated certain SWP Load as interruptible, *id.* at 56, it must be interruptible. There is no law or logic behind this argument. If the ISO's opinions or desires sufficed to makes SWP's pump Loads interruptible, the ISO would not have asked SWP to curtail its pump Loads to address line loadings south of Magunden, only to be refused. It would have simply interrupted the Loads. Similarly, the ISO's delay in revising its procedure to reflect the termination of SWP's contract with SCE, SWP Br. at 54, proves nothing. Under the procedure, the ISO would have notified SWP to take action under the contract. Inasmuch as SWP was aware of the contract termination, it would have informed the ISO of the lack of authority.¹¹

SWP asserts that its transmission is interruptible for the purposes of reduced cost responsibility because of the ISO's "right to interrupt" its pump loads. SWP Br. at 56. It cites four factors as evidence of the ISO's right to interrupt. The first is its Participating Load activities. *Id.* SWP's Participating Load activities are its participating bids in the ISO's Energy markets. In such circumstances, SWP is acting the same as a

¹¹ In fact, SWP itself notes that, even while the procedure calls for the tripping of SWP Loads, the ISO only requested that SWP interrupt pump Load, and did not enforce an involuntary curtailment. SWP Br. at 54.

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

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

Third, SWP mentions its participation in the Remedial Action Schemes or RAS. SWP Br. at 56. The only evidence that SWP discusses is a data response in SWP-22L in which the ISO discusses an RAS for a double line outage on Path 15, and notes that Must-Offer Generation is only committed for single contingencies. Thus, SWP receives the same benefits as every other entity as a protection against single contingencies. Moreover, SWP is compensated for such participation in RAS in the event of a double contingency. See *Pacific Gas & Electric Co.*, 109 FERC ¶ 61,255 at P 65 (2004)

(discussing SWP's compensation for Path 15 RAS). SWP has not explained why its paid participation in a RAS for a double contingency should excuse it from sharing the cost for protection from single contingencies.

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

As for RAS schemes, as noted above, Must-Offer is only intended for single contingencies. The remainder of SWP's "evidence" is the understandable belief of ISO personnel that interrupting pumps, and therefore moving water at a later time, is less important than interrupting firm retail load, where it is possible to distinguish the dispensible from the indispensable, such as traffic lights and in-home medical equipment. SWP Br. at 56. Although SWP omits it, for example, the Willis deposition

that it cites goes on to discuss ISO procedures are being corrected to ensure that SWP pumps are not curtailed before firm retail Load. SWP-28B at 34.¹²

As its final effort to qualify as interruptible, SWP asserts that the ISO and SCE treat SWP pump load as interruptible in transmission planning. Here it merely repeats its assertions about the “uniform view” of ISO personnel and cites a statement about its Edmunston pumps in SCE’s long term transmission plan – a statement SCE admitted was a mistake. SWP Br. at 56; Exh. SWP-51 at 39; Tr. 1220:1-5 (Hansen). This does not constitute a demonstration of interruptible transmission service.

I. Whether load serving entities (“LSEs”) should be permitted to self-provide local generation (or inertia) and thereby avoid SCIT related MLCC costs.

As described in the ISO’s Initial Brief, Southern Cities, and their witness Mr. Tang, propose a mechanism by which LSEs may self-provide inertia in order to avoid SCIT-related Zonal MLCC costs. Although the program may have some merit in the abstract, these are outweighed by the implementation difficulties related to such a proposal. ISO Br. at 35-38.

In addition, Southern Cities proposal goes beyond the recommendations of alternative allocations of Must-Offer costs in the event that the ISO’s proposed allocation is determined to be unjust or unreasonable. Southern Cities are not recommending an alternative allocation, but rather a revision of the operation of the Must-Offer obligation itself. As with SWP’s concerns regarding the ISO’s management

¹² Although SWP relies upon this portion of Mr. Willis’ deposition testimony repeated as substantive evidence in its brief, the ISO notes that it was not included among the matters upon which SWP’s witness relied and was indeed *only* used at the hearing in the cross-examination of SCE’s witness to ask whether he agreed. Tr. 1235:8 – 1238:9.

of Congestion, such matters are better pursued in conjunction with the MRTU proceeding or in other Commission proceedings, not in the context of the limited portion of Amendment No. 60 that was set for hearing.

J. How should the ISO treat MLCC costs related to must offer waivers denied for more than one reason?

The ISO has no reply argument on this issue.

K. Whether the ISO should allocate System Minimum Load Costs based on deviations between metered load and Day-Ahead scheduled load (where the total Day-Ahead scheduled load deviates from the total metered load by more than a 5 percent threshold).

The ISO has no reply argument on this issue.

L. Whether Start-Up and Emissions costs of units denied must offer waivers should be allocated in the same manner as those associated with Minimum Load Cost Compensation (“MLCC”) and whether a revision to the allocation of these costs even should be addressed in this proceeding.

The ISO has no reply argument on this issue.

II. Attachment E Issues

A. Whether Attachment E as included in the ISO’s original filing of May 11, 2004 should be deemed part of Amendment 60 to the ISO Tariff as filed.

The ISO has no reply argument on this issue.

B. Whether the criteria used by the ISO to classify units committed under the Must Offer Wavier Denial (MOWD) process should be included in the ISO Tariff.

The ISO has no reply argument on this issue.

III. Whether the proposed definition of Reliability Services Costs is just and reasonable.

The ISO has no reply argument on this issue.

IV. Ancillary Services Issues

A. Does the ISO have the authority to commit a Generating Unit under the Must Offer Obligation to provide Ancillary Services?

Commission Trial Staff finds no authority in the ISO Tariff for the ISO to commit a Generating Unit under the Must Offer obligation to provide Ancillary Services. Staff Br. at 70-71. SWP protests that the ISO should not be allowed to bypass the ISO Tariff provisions for the provision of Ancillary Services, and that the ISO cannot “make up new reasons” for incurring reliability-oriented costs without first obtaining clear tariff authority. SWP Br. at 65.

In its Initial Brief, the ISO explained that Section 11.6.2 explicitly authorizes the ISO to make its determinations regarding MOWD based on the need for operating reserve requirements. SWP’s arguments reveal a fundamental misunderstanding of the MOWD process. When the ISO denies a Must-Offer waiver request because it foresees a shortage of Ancillary Services, it has not bypassed its markets or even procured Ancillary Services. All that it has accomplished is ensure that the Generating Unit is online and that its uncommitted capacity will be available in the ISO’s real time Energy market.

Subsequent to Amendment No. 60, however, Generating Units that are denied Must-Offer waivers may bid into the Ancillary Service markets and, if their bids are accepted, do not forfeit MLCC payments. See *California Indep. System Operator Corp.*, 108 FERC ¶ 61,022 at PP 83, 87-88 (2004). The ISO may therefore issue MOWDs in

the reasonable expectation that most, if not all, of the Generating Units for which denials are issued will bid their uncommitted capacity into the Ancillary Services markets, relieving the ISO's anticipating shortage of Ancillary Services. The ISO does not "bypass" its Ancillary Services markets by MOWD, it merely increases participating in those markets.

If there is any question about the ISO's authority to use MOWDs in its discretion to ensure adequate operating reserves in the form of Ancillary Services, it should be resolved by the Commission's order approving Section 11.6.2:

The Commission's April 26 Order set forth that the purpose of the Must-Offer Obligation is to ensure that all units that are able to run but are not already scheduled to run are made available to the ISO in the real-time market. The Must-Offer Obligation is designed to ensure that the ISO will be able to call upon available resources in the real-time market to the extent energy is needed. A generator that has available energy in real time should be willing to sell that energy since it has no alternative purchaser. *Additionally, the Commission noted that the Must-Offer Obligation should provide the ISO adequate capacity to help meet operating requirements.*

In conditionally approving the ISO's proposed exemption procedures from the Must-Offer Obligation, the Commission intended to assist generators with long start-up times and high Minimum Load Costs and to provide flexibility to the ISO regarding the balancing of load and resources. Therefore, we find the ISO's proposal that exemptions will be granted so as to (1) provide sufficient on-line generating capacity to meet operating reserve requirements; and (2) to account for other physical operating constraints of generating units reasonable.

....

We agree with Reliant that the ISO must revise its Tariff to provide that a generator be informed that a waiver request has been accepted, denied, or revoked, including the reason(s) for the decision, which must be non-discriminatory. With respect to the ISO's Tariff provision that such exemptions be granted by the ISO at its sole discretion, we find this provision not unreasonable as such discretion is reviewable by the Commission. Generators can file complaints if they believe the ISO has used its discretion in an arbitrary or discriminatory manner. With respect to

the intervenors concerns regarding transparency, we believe that with our required Tariff modifications, this requirement will be met.

San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al., 99 FERC

¶ 61,158 at 61,630 (2002) (footnotes omitted).

B. Should Scheduling Coordinators who self-provide Ancillary Services be allocated costs of MLCC for Ancillary Services?

Commission Trial Staff contends that Scheduling Coordinators that self-provide Ancillary Services should not be allocated costs of MLCC for Ancillary Service because the ISO has no authority to commit Generating Units because of Ancillary Services needs. Staff Br. at 71. The fallacy of that argument is discussed in the previous section.

SWP contends that Scheduling Coordinators that self-provide Ancillary Services would be double charged if allocated costs of MLCC when the ISO commits Generating Units because of an expected shortage of Ancillary Services bids. SWP Br. at 68. The ISO explained in the testimony of Ms. Bodine and in its Initial Brief that charges for Ancillary Services and MLCC are fundamentally different charges; SWP disagrees, asserting that “reserving minimum load capacity by denying a must offer waiver to meet Ancillary Services needs serves the same purpose as obtaining Ancillary Services through a day ahead market,” citing Ms. Bodine’s testimony. *Id.* SWP both fundamentally misunderstands the function of MOWDs and misstates Ms. Bodine’s testimony at Tr. 739:7-13 and 744:4-18. SWP Br. at 68. Ms. Bodine simply states (1) that must-offer waivers will be denied if there is a concern that there will be insufficient Ancillary Services bids and (2) that the costs are incurred because of the

lack of Ancillary Services. Ms. Bodine nowhere suggests that the function of the MOWDs is to reserve capacity.

In fact, one of this issues in Amendment No. 60 was whether to provide Generators denied a must-offer waiver with a capacity payment. Among the reasons the ISO cited for not providing a capacity payment is that “no specific capacity is being reserved under the must-offer obligation, and the CAISO has no right to a specific amount of capacity under the must-offer obligation.” *California Indep. System Operator Corp.*, 107 FERC ¶ 61,022 at P 108 (2004). The Commission upheld the ISO’s decision not to provide a capacity payment. *Id.* at P 111. In contrast, if a Generator offers capacity in the Ancillary Services market, and the bid is accepted, the capacity must remain unloaded. ISO Tariff §§ 2.5.21, 2.5.24 (Item by Reference 1 at Sheets 97 *et seq.* and 110L – 110M). If a Generating Unit generates Energy from capacity accepted in the ISO’s Ancillary Services market, other than in response to an ISO dispatch order pursuant to the provision of the Ancillary Services, it will forfeit its Ancillary Services payment. ISO tariff Section 2.5.26.2.1 (Item by Reference 1 at Sheet 114).

Docket No. EL04-103

- I. **Whether the manner in which the ISO allocated Must Offer Obligation related charges, including MLCC costs prior to October 1, 2004 was just, reasonable and not unduly discriminatory.**

The ISO has no reply argument on this issue.

- II. **Whether the refund effective date of July 17, 2004 should be conditioned in any way.**

The ISO has no reply argument on this issue.

CONCLUSION

Wherefore, the ISO respectfully requests that the Presiding Judge find Amendment No. 60 to be just and reasonable, as discussed above.

Respectfully submitted,

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Dated: September 2, 2005

CERTIFICATE OF SERVICE

I hereby certify I have this day served the foregoing document on each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, California, on this 2nd day of September, 2005.

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