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May 9, 2001

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Pacific Gas & Electric Company
Docket No. ER00-2360-000 *et al.*

Dear Secretary Boergers:

Enclosed for filing please find one original and fourteen copies of the Reply Brief of the California Independent System Operator Corporation in the above captioned proceeding.

Two additional copies of the filing are also enclosed. Please stamp the additional copies with the date and time filed and return them to the messenger.

Respectfully submitted,

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas & Electric Company	)	**Docket Nos. ER00-2360-000**
	)	**ER00-2360-001**
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	)	

REPLY BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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Dated: May 9, 2001

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REPLY BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

To: The Honorable Bruce L. Birchman,
Presiding Administrative Law Judge

Pursuant to Rule 706 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.706 (2000), and the Order Concerning Trial Schedule issued by the Presiding Administrative Law Judge in the above-captioned proceeding on March 13, 2001, the California Independent System Operator Corporation ("California ISO" or "ISO") submits its Reply Brief in this proceeding.

I. DISCUSSION OF ISSUES

Consistent with the order of the Presiding Judge, the California ISO presents its reply to arguments raised in the initial brief according to the issues in this proceeding under the headings set forth in the Joint Stipulation of Issues as adopted by the Presiding Judge on March 23, 2001. The ISO has limited its reply to those issues on

which it has concluded that further explanation is appropriate.[1] With regard to other issues, the ISO relies upon its discussion in its Initial Brief, and its failure to respond to those issues in its Reply Brief should not be considered a concession of the validity of opposing arguments.

Issue 4: Are ETC or TO Wholesale Customers Doubled Charged For RS?

The ISO did not address this issue in its Initial Brief. Other parties, however, have raised issues to which the ISO must respond. Dynegy Power Services, Inc., ("Dynegy") and the Department of Water Resources ("DWR") assert that RMR costs constitute double charging for voltage support and black-start. Dynegy relies solely upon the fact that ISO Tariff provisions allocate voltage support charges to Scheduling Coordinators. Initial Brief of Dynegy Power Services, Inc. ("Dynegy Br.") at 5. DWR also relies upon Trial Stip. 9, which provides that the ISO has charged Scheduling Coordinators for voltage support from two RMR units, for a total cost during 2000 of $918,224. Initial Brief of the California Department of Water Resources ("DWR Br.") at 10.

This evidence does not establish that RMR costs double charge for voltage support and black start services. There is no available information regarding the manner in which RMR Owners account for any amounts that the ISO collects from Scheduling Coordinators and pays to the RMR Owners, and absent such evidence,

[1] The ISO notes that certain parties have supported their arguments with quotations from depositions of ISO personnel that were not witnesses. *See* Initial Brief of the Transmission Agency of Northern California ("TANC Br."). at 32-33; Initial Brief of the Northern California Power Agency ("NCPA Br.") at 19-20;. These quotations are cited as primary evidence, even though they were introduced into the record only as support for the conclusions of other witnesses and even though the ISO's witness was not questioned about any of these quotations. The ISO does not necessarily disagree with the substance of the quotations, but wishes to emphasize that the statements made by employees in depositions stand as the opinion or understanding of the deponent but do not necessarily represent the positions of the ISO. The actual positions of the ISO are contained in its direct case.

there is no basis for a finding of double charging. For example, the evidence establishes that RMR Owners receive payment from the market for the Energy generated by RMR Units; there is no double charging, however, because those payments are credited against the RMR invoices. *See* Exh. PGE-16 (Weingart Direct Testimony) at 7:10-12; Tr. at 1374:10-16 (Le Vine); Exh. ISO-1 (Le Vine Answering Testimony) at 6:17-20. Without evidence about whether voltage support payments are similarly credited, one cannot determine whether there has been double charging.

Even assuming arguendo that the RMR Owner did not credit the Scheduling Coordinator payments for voltage support against the RMR invoice, any overlap of charges would be insignificant. Joint Stipulation No. 9 identifies charges related to only two RMR Units for a total of $918,244, which is allocated to *all* Scheduling Coordinators based on peak demand. Using PG&E's allocation of costs based on coincident peak demand, the share of *all* wholesale TO Tariff customers would be $137,736.60. *See* Exh. PGE-1 (Kozlowski Direct Testimony) at 14:1-3 (showing an allocation of 15% of PG&E's RS costs to wholesale customers). The share of an individual wholesale Load, such as DWR, would be only a fraction of that amount. In contrast, DWR estimates its share of PG&E RS costs as $12.8 million. Exh. DWR-8 (Werner Initial Testimony) at 4:2-5. Under such circumstances, double billing for voltage support, even if it could be established – which it cannot – cannot be a significant factor in this proceeding.

Dynegy also asserts that it is double-charged when it purchases the Energy that is produced by an RMR Unit. This assertion is discussed in the context of Issue 5.A, below.

Issue 5.A: What is the Purpose of Reliability Must-Run ("RMR") Contracts and Local Out of Market ("OOM") Calls?

In its Initial Brief, the ISO described RMR Units as serving a transmission function. Initial Brief of the California Independent System Operator Corporation ("ISO Br.") at 3-4. In discussing the purpose of RMR Contracts or in other contexts, various parties have offered permutations of the argument that RMR Contracts mitigate Generation market power and therefore serve a Generation function. *See, e.g.*, TANC Br. at 23-25; DWR Br. at 12-13; NCPA Br. at 21-22; 35-36, Initial Brief of Commission Trial Staff ("Staff Br.") at 41; Dynegy Br. at 10-11,15, 20. These arguments, however, fail to take into account the difference between the locational market power that RMR Units can exercise and typical Generation market power.

If a unit has Generation market power – i.e., sufficient control of Generation resources to be able to influence market prices– an RMR Contract will not serve to mitigate that market power. ISO Br. at 5. Under the RMR Contract, the RMR Unit Owner can accept market payment in lieu of payment under the RMR Contract. Exh. PGE-16 (Weingart Direct Testimony) at 7:10-12; Tr. at 289:13-25 (Weingart); Tr. at 291:8-19 (Weingart); Tr. at 1374:10-16 (Le Vine). If the RMR Owner has sufficient resources, it can influence the Market Clearing Price, as by withholding Energy from other Generating Units that it owns from the market. Nothing in the RMR Contract will prevent such an exercise of market power.

Rather, the RMR Contract serves to mitigate a different form of market power (often denominated locational market power), which arises only when, taking into account the existing Load and Generation, there is lack of adequate transmission capacity into a specific area. ISO Br. at 5. Under such circumstances, the ISO must

call upon a specific Generating Unit that has not been and would not be selected by the market, generally due to the price of the Energy. Because of the transmission constraints, the ISO would have to pay whatever price the owner of the Generating Unit demanded. Exh. ISO-1 (Le Vine Answering Testimony) at 5:13-16 This price, however, would not determine the Market Clearing Price because the Unit was not being selected through the market process.

Thus, the locational market power that an RMR Contract (or the payment provision for a local out-of-market ("OOM") call) mitigates arises not because of the control of a quantity of Generation services; it arises because the specific Generating Unit, in light of its location and the configuration of the transmission system, is uniquely capable of fulfilling a reliability need.[2] In essence, the unit has "reliability market power."

As discussed in the ISO's Initial Brief, the payment structure of the RMR Contracts reflects the fact that the RMR Contracts, by ensuring local reliability, are fulfilling a transmission function. ISO Br. at 4. The Energy produced by the RMR Unit is sold through the market. The responsible Participating Transmission Owner does not pay the cost of that Energy; the purchaser does. Tr. at 291:18-12 (Weingart). The responsible Participating Transmission Owner pays only the difference between the Energy cost and the RMR Contract, *i.e.*, the premium that the RMR Owner receives because of the reliability benefit. *See* Exh. PGE-16 (Weingart Direct Testimony) at 7:10-12; Tr. at 1374:10-16 (Le Vine); Ex. ISO-1 (Le Vine Answering Testimony) at 6:17-20. This is a cost related to the transmission function of the RMR Unit.

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[2] In its Initial Brief, DWR asserts that, according to Ms. Le Vine, RMR Contracts are the ISO's only means to ensure reliability. DWR Br. at 13. Ms. Le Vine, however, explicitly corrected that testimony on redirect examination. Tr. at 1408:16-24.

This distinction also refutes Dynegy's arguments that charging TO Tariff customers for RMR costs would be double charging if the customer happened to be the entity that purchased the Energy. Dynegy Br. at 9. Contrary to Dynegy's assertion, the payments are distinct. One is a payment for Energy that is made by the market through a Scheduling Coordinator to the RMR Owner. The other is a payment for reliability that made by a Participating Transmission Owner, such as PG&E, and which PG&E proposed to share among a variety of users of the ISO Controlled Grid. Although the RMR Contract includes a payment for variable costs, the market payment is netted against that amount. Tr. at 1374:10-16 (Le Vine); Ex. ISO-1 (Le Vine Answering Testimony) at 6:17-20. The Participating Transmission Owner, such as PG&E, are only responsible for paying the difference (i.e. the cost incurred to support the ISO Controlled Grid), and only that amount is included in PG&E's RS costs.

Dynegy's argument that the Commission's order in *San Diego Gas & Electric Co., et al.*, 93 FERC ¶ 61,294 (2000), directing PG&E to serve its native Load from its Generation, requires that the native Load bear the RMR costs, Dynegy Br. at 31, is similarly flawed. The Commission's Order concerns the Energy produced by PG&E's units, not the reliability function they serve. The Presiding Judge and the Commission may well conclude that TO Tariff customers should not bear a portion of the payment for the reliability function, but that conclusion cannot properly be based on a finding that such payment constitutes a payment for the Energy.

Issue 5.B: Does ETC or TO Wholesale Transmission Service Cause the Need for RS?

In its Initial Brief, the ISO explained that although customers who arrange adequate Generation and firm transmission to serve their Loads do not require RMR,

TO Tariff customers do not fall into that category. ISO Br. at 7. TANC argues to the contrary. Citing Staff Witness Deters, TANC states, "Like open access tariff transmission service, the transmission service that a wholesale transmission customer receives under the ISO's Tariff (with the purchase of firm transmission rights) is 'firm transmission to ensure that its resources are brought to load.'" TANC Br. at 29. This statement is inaccurate. As is apparent from a review of the relevant sections of the ISO Tariff, FTRs under the ISO Tariff (the only available "firm transmission rights") are not the same as firm transmission rights under the pro forma open access transmission tariff. *See* Trial Stip. 10, App. A at 26-27, 29.

The Commission has made this clear. In denying TANC's request for rehearing of the Commission's approval of the ISO's program, the Commission stated:

> TANC, Cities/M-S-R, and DWR claim that the Commission erred in not requiring the ISO to offer firm physical transmission rights as part of, or in addition to, FTRs. . . . Cities/M-S-R, TANC and DWR claim that while a transmission customer served under the *pro forma* tariff receives service that is as firm as the transmission provider's use of its own transmission system to reliably serve its native load customers, FTRs fail to provide comparable rights.
>
> . . .
>
> We will deny the requests for rehearing in this regard. We have determined that FTRs need not provide customers with firm physical transmission service in order for them to secure transmission service that is as good as or superior to the service under the Order No. 888 *pro forma* tariff.

California Independent System Operator Corp., 88 FERC ¶ 61,156 at 61,524-25 (1999).

Thus, a TO Tariff customer cannot be assured of "firm transmission to ensure that its resources are brought to load." While the Presiding Judge and the Commission may decide that TO Tariff customers should not bear a portion of PG&E's RS costs, that

conclusion should not be premised on the claim that TO Tariff customers have acquired sufficient transmission to meet their Load.

Issue 5.J: Should TO Wholesale Customers Serving Loads Outside PG&E's Former Control Area Be Allocated a Portion of the RS Costs

See discussion of issue 5.M, below.

Issue 5.M: Is PG&E's Proposed Allocation of RS Cost to Wholesale TO Tariff Customers Utilizing "Wheel-Out" or "Wheel-Through" Service for Load Outside PG&E's Control Area Permitted by the Commission's February 23, 2001, Order on Rehearing, San Diego Gas & Electric Co., Docket No. ER01-322-002, 94 FERC ¶ 61,200 (2001)?

In its Initial Brief, the ISO asserted that the Commission's Order in *San Diego* prohibited the assessment of RS costs to customers that wheel to Loads outside PG&E's former Control Area but not to customers that wheel to Loads within PG&E's former Control Area. ISO Br. at 11-12. A number of parties, citing the Commission's reference to customers that wheel out or wheel through, contend that *San Diego* would prohibit PG&E's assessing RMR costs to any wheeling customers. This, however, ignores entirely the Commission's order that was under review and the Commission's reasoning.

In its initial order in the *San Diego* proceeding, the Commission specifically stated that it approved the San Diego Gas & Electric Company's ("SDG&E's") proposal to assess RMR and OOM costs to retail and wholesale Loads within the company's historic *control area*. *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,334 at 62,132, 62,134. This is the order that the California Public Utilities Commission ("CPUC") challenged, and the Commission confirmed in 94 FERC ¶ 61,200.

In the Order on Rehearing, the Commission was thus only concerned with the CPUC assertion that the costs should be assessed to Loads outside SDG&E's historic Control Area. It concluded that such charges were inappropriate for two reasons.

First, it stated that such charges would be inconsistent with the ISO Tariff's allocation of RMR costs, under which those costs were allocated to the Participating Transmission Owner in whose Service Area (or adjacent to whose Service Area) the RMR Unit is located. *San Diego Gas & Electric Co.*, 94 FERC ¶ 61,200 (2001) at 61,745. Second, the Commission concluded that assessing RMR costs would constitute pancaking, in the same way as charging customers with Loads outside the ISO Control Area for Ancillary Services. *Id.* at 61,746. The Commission noted that, unlike Imbalance Energy, Ancillary Services costs are not properly charged across multiple Control Areas, and that the Loads outside the ISO Control Area should not be charged. *Id.* The Commission did not find that charging Loads within the ISO control area would be prohibited pancaking. Indeed, the Commission was not called upon, and did not opine about, charges to Loads within SDG&E historic control area. That issue was not raised by the CPUC and was not before the Commission.

The ISO notes that the Commission's conclusions regarding the propriety of distinguishing Loads within SDG&E's former Control Area defeat the arguments of the Transmission Agency of Northern California ("TANC") and the Sacramento Municipal Utility District, in Issue 5.C, TANC Br. at 34, Initial Brief of the Sacramento Municipal Utility District ("SMUD Br.") at 21, that there is no basis for distinguishing TO Tariff customers within PG&E's former Control Area from other TO Tariff customers and, in

7.J, TANC Br. at 34, that PG&E's proposal discriminates against TO Tariff customers within its former Control Area.

Issue 6.D: Should the Commission's December 15, 2000 Decision in *San Diego Gas and Electric Co., et al.*, 93 FERC ¶ 61,294, at 62,001 (2000), Be Considered as a Factor in the Outcome of this Proceeding?

The ISO has discussed this issue in the context of Issue 5.A above.

Issue 7.I: Should the ISO Be Responsible for Collecting the RS Charges?

In its Initial Brief, the ISO contended that it should not be responsible for collecting PG&E's RS charges from TO Tariff customers. ISO Br. at 13. PG&E contends that the ISO is the only entity with a direct billing relationship with TO Tariff customers. Unlike transmission charges under the TO Tariff or ISO charges for services it procures through its markets, such as Ancillary Services, however, PG&E's RS costs are not identified in the ISO Tariff. They are simply and exclusively charges under PG&E's tariffs. The mere fact that the ISO has billing relationships with certain parties does not justify forcing the ISO to collect charges that arise under other parties' tariffs.

PG&E also states that the ISO "has not adequately demonstrated that the burden imposed by performing this service for PG&E . . . is unreasonable or excessive." PG&E Br. at 28. PG&E seems to have forgotten that *it* bears the burden of proof in demonstrating that *its* proposed tariff is just and reasonable. *See, e.g., New York State Electric & Gas Corporation*, 82 FERC ¶ 61,209 (1998) at 61,824 (noting that "[u]nder Section 205 of the FPA, the burden of demonstrating that the tariff rate is just and reasonable falls on the filing public utility"). It is particularly important and necessary for such burden to be met when the tariff would not merely set rates, but impose affirmative obligations on a party that is not even receiving services under the Tariff. Adoption of

PG&E's proposal would force the ISO into a new business -- not part of its current operations -- of settling charges under other entities' tariffs. PG&E should not be allowed to force another party to undertake new burdens for which it has no budget, software, and personnel, particularly when PG&E does not propose to pay for such service. Moreover, adoption of PG&E's proposal could set a precedent under which the ISO could be held responsible for collecting charges for multiple other entities attempting to pass through costs incurred under the ISO Tariff, interfering with the ISO's ability to fulfill its primary function – operating and preserving the reliability of the ISO Controlled Grid.

PG&E's argument is little more than an assertion that it would be more convenient for the ISO to collect its rates for it. An assertion of convenience, however, is not equivalent to a showing that imposing a burden on another is just and reasonable. Accordingly, the Presiding Judge and the Commission should conclude that PG&E cannot properly require the ISO to collect PG&E's RS costs.

II. CONCLUSION

WHEREFORE, the California ISO requests that the Presiding Judge rule on the issues in this proceeding in accordance with the discussion in the ISO's Initial Brief and above.

Respectfully submitted,

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Dated: May 9, 2001