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

**Duke Energy Oakland LLC** ) **Docket No. ER98-2669-000**

**MOTION TO INTERVENE, MOTION TO CONSOLIDATE,**
**MOTION TO REJECT FILING AND PROTEST OF**
**CALIFORNIA INDEPENDENT SYSTEM**
**OPERATOR CORPORATION**

To the Commission:

Pursuant to Rules 211 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211 and 385.214, the California Independent System Operator Corporation (ISO), hereby moves to intervene in and protests the above-captioned filing by Duke Energy Oakland LLC (Duke) in connection with the Reliability Must Run (RMR) Unit located in Alameda County, California. In addition, the ISO hereby moves for the following Commission action:

(1) that the Commission consolidate this docket with the related Notice of Termination for the Moss Landing and Oakland units filed by Pacific Gas and Electric Company (PG&E), Docket No. ER98-2785-000;[1] and Duke's filing in connection with the Moss Landing Must Run unit, Docket No. ER98-2668; and

(2) that the Commission reject Duke's initial rate filing and PG&E's related Notice of Termination because they fail, as a matter of law, to meet the limited conditions under which PG&E may terminate its RMR Agreement without ISO consent or, in the alternative, deny Duke's requested effective date and set all

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[1] Interventions and protests in the PG&E Notice of Termination filing are due on May 20, 1998. The ISO will file a motion to intervene and protest in that docket, which will include this pleading as an attachment.

matters for hearing, with the effectiveness of Duke's filings and PG&E's termination to be contingent on a final Commission order.

The ISO respectfully submits that prompt and decisive Commission action is needed in this proceeding for several reasons. First, prompt action is needed to avoid similar proceedings being filed by the purchasers of the other RMR units that have been and will be divested by the California public utilities. This could potentially overwhelm both the ISO and the Commission in rate filings as owners seek to "improve" the RMR Agreement. Second, there is a significant risk to the reliable operation of the ISO control area. The ISO has determined that its ability to maintain the same reliability of service will be seriously impaired if it is compelled to purchase energy under RMR contracts with significantly varying terms and conditions. Accordingly, the ISO urges the Commission to reject Duke's efforts to force the ISO to operate under conditions inconsistent with the maintenance of reliable service.

Third, the Duke filing contains certain terms and conditions that will expose the ISO to substantial financial liability in connection with the operation of the RMR unit. If FERC accepts the Duke filing and the PG&E filing, then the ISO will be in immediate violation of a key financing document of the ISO, the Reimbursement Agreement. Article VII (Negative Covenants of the ISO), Section 7.9 (Must Run Unit Agreement) will be violated and as a result the ISO will be in default under the Reimbursement Agreement's VIII (Defaults and Remedies), Section 8.1c (Events of Default). The banks will restrict access to the proceeds of the bond issuance, impose large increase penalties, force early retirement of disbursed funds in 1999 and require that funds not disbursed be

used to collateralize the Letter of Credit and to redeem issued bonds.[2] Any of these results will substantially increase the ISO's costs of operating the ISO Controlled Grid, which must be passed on to users.

Finally, by accepting the Duke filing, the Commission will be undermining a keystone to the California ISO structure—the requirement for use of *pro forma* agreements for the myriad of contractual relationships that are required when reliability operations are driven by a market engine.

## I. SERVICE

The names and addresses of the persons to whom communications concerning this filing are to be addressed are as follows:


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[2] PG&E's proposed RMR agreement contains some the same objectionable financial terms and conditions as the Duke proposal, but those concerns are not objectionable to the ISO lenders so long as PG&E is selling RMR services to the ISO, as well as buying those services, because the ISO has the right of set off against PG&E.

## II. DESCRIPTION OF THE PARTY

The ISO is a non-profit public benefit corporation organized and existing under the laws of the State of California, in which it is authorized to do business. On March 31, 1998, the ISO took control of and currently operates the transmission systems of Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (SDG&E) and Southern California Edison Company (SCE). The ISO is responsible for maintaining the reliability of electric transmission scheduled into, out of and through the ISO Control Area. The activities of the ISO are subject to the jurisdiction of the Commission.

## III. MOTION TO INTERVENE

On April 24, 1998, Duke tendered for filing under Section 205 a Rate Schedule to establish terms and conditions of the Reliability Must Run Services that Duke intends to provide to the ISO through its Oakland generating unit. Duke requests authorization for a new Reliability Must Run Agreement (RMR Agreement) with initial rates to be accepted by the Commission effective June 23, 1998.

As a party to the RMR Agreements and the purchaser of the energy and ancillary services offered in these agreements, the ISO has a direct and substantial interest in this proceeding. Moreover, the ISO's interests cannot be adequately represented by any other party. Accordingly, the ISO respectfully requests that it be permitted to intervene herein with full rights of a party.

## IV. SUMMARY OF ARGUMENT

At present, the California restructuring presents the only example of an independent system operator charged with reliability operations but dependent on a market engine to obtain the tools to maintain reliability. As such, it is particularly dependent on having a multitude of contractual arrangements (*e.g.* the ISO currently has over 140 jurisdictional contracts on file with the Commission). To be able to administer

those contracts efficiently and fairly, a fundamental precept of the ISO design has and continues to be the use of *pro forma* agreements for each of the necessary relationships. There are serious operational consequences to not having uniform terms and conditions, as detailed in VI.A.b. below. Dispatching RMR units within the overlapping frameworks of market auctions and RMR contracts is a complex process. Without uniform RMR contracts, the system operator would have to consult each individual contract before calling on that unit to provide service to ensure the ISO was complying with the terms and conditions of that contract. This would inevitably create delays, and since RMR units are, by definition, those units that must run to ensure system reliability, the potential price to be paid for any delays within these processes is the loss of system reliability.

Moreover, there are significant economic inefficiencies. This is particularly so for the purchase of RMR services, which are a significant component of the overall cost of transmission[3] and which the ISO must evaluate and competitively select at least annually.

Reliability Must Run service is, in effect, a substitute transmission service. Likewise, the ability of the ISO to call on RMR units for supply of ancillary services not provided by the market is also a transmission service. As a result, RMR arrangements are *sui generis* when compared to typical wholesale sales arrangements and the Commission's pronouncements in this matter will have broad ramifications not only in California, but elsewhere when the grid operator does not own or directly control generation.

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[3] For example, the ISO estimates that it will collect approximately $680 million for ancillary services markets, real-time energy, congestion and wheeling charges, of which $150 million will represent the grid management charge. In contrast, the estimated invoices for RMR services, which are passed on to customers in the distribution rate, are between $1 and $2 billion annually.

The ISO understands that divestiture of generation is in the public interest and the ISO does not want to delay the divestiture of these units. However, the ISO urges the Commission to reject Duke's filing for the serious operational and financial reasons described below. This action does not leave PG&E and Duke without an opportunity to effectuate the divestiture. The Commission should inform PG&E and Duke that they can arrange an assignment of PG&E's filed rate, or Duke can file a rate with substantially the same terms and conditions. Duke could then file a change in those rates, and ask that it be implemented prospectively after establishing that the changed terms are shown to be just and reasonable.

Here the Commission's refund and suspension authority will not protect the ISO (and consumers). As discussed below, the ISO will incur operational and financial harm if Duke's unilateral filing is accepted subject to refund. In analogous situations, the Commission has rejected rates from entities that have not shown that there are adequate safeguards to protect captive customers. *KNI Interstate Gas Transmission Co.*, 68 FERC ¶ 61,401, at 62,585-86 (1994) (rejecting filing where KNI had not shown that it lacked significant market power and had not proposed safeguards to adequately protect captive customers).

Finally, Duke's filing lacks a proper foundation. Duke may only initiate service from Oakland if PG&E is first permitted to terminate service from Oakland. PG&E's notice of termination and Duke's rate filing are so inextricably linked that the Commission must consider them as a single application and consolidate them for consideration. The Commission's action in the consolidated proceeding must be to summarily reject PG&E's notice of termination and defer any action on Duke's filing until the condition precedent—a valid termination by PG&E—is accomplished. The

notice of termination is inconsistent with the terms of PG&E's filed rate for Oakland. That rate provides that PG&E may transfer the facility only to a purchaser willing to provide service under substantially the same terms and conditions. As detailed in this pleading, the Duke terms and conditions are materially different from those in the PG&E filed rate. The material differences will seriously impair the ISO's ability to provide reliable electric transmission service. Moreover, the terms will impose substantial additional financial costs on the ISO to the detriment of all California ratepayers relying on ISO service for delivery of their electric energy. These facts are so self-evident that the Commission should reject PG&E's filing as a matter of law, as the ISO will request in its protest to PG&E's Notice of Termination. This preclusion of conveyance and termination will prevent Duke from acquiring the Oakland facility. Thus, its filing of the proposed rate schedule, which is the subject of the instant proceeding, is without foundation. Should the Commission not grant summary disposition on the question of whether PG&E's termination pre-condition has been satisfied, (*i.e.,* the filing by a successor of a rate with substantially the same terms and conditions) then the Commission should suspend PG&E's termination notice for a full five months and set for expedited hearing the question of whether PG&E's requested termination is just and reasonable under the circumstances.

## V. MOTION TO CONSOLIDATE - THIS DOCKET NO. ER98-2669-000, DUKE'S FILING ON MOSS LANDING, DOCKET NO. ER98-2668-000, AND THE RELATED PG&E NOTICE OF TERMINATION ARE INEXTRICABLY INTERTWINED AND THEREFORE SHOULD BE CONSOLIDATED

Under the Commission's Rules of Practice and Procedure 18 C.F.R. § 35.15, PG&E must file a Notice of Termination with the Commission in order for Duke's RMR Agreement to become effective and for Duke to assume ownership and control of the sold

generating facilities. PG&E submitted its Notice of Termination on April 30, 1998 in Docket No. ER98-2785-000 for both the Moss Landing and Oakland RMR units. The ISO respectfully requests that PG&E's Notice of Termination and Duke's filing be consolidated.

The fundamental issue in each of these dockets is whether PG&E has met the conditions under which it is allowed to convey RMR units to a new purchaser. As a current supplier of must run service from the Oakland unit, PG&E can only terminate its service to the ISO if it sells the RMR facility to a purchaser who (1) executes a contract with the ISO or (2) files a rate schedule with FERC to provide the ISO the right to purchase energy and ancillary services *under substantially the same terms* and specified cost-based rates. As discussed further below, the terms and conditions in Duke's filing are not substantially similar to the terms and conditions in PG&E's agreement. PG&E should not be allowed to terminate service to the ISO until it complies with its current agreement with the ISO. Likewise, Duke should not be allowed to file a RMR agreement for service to the ISO that was not properly conveyed to it.

Because PG&E's ability to terminate its must RMR to the ISO and, consequently, Duke's authority to file the successor RMR agreement are fundamentally intertwined, the dockets should be consolidated. Moreover, the ISO agrees with Duke that it is appropriate to consolidate the instant proceeding with that of its companion filing regarding the RMR rates for Moss Landing. See Duke Transmittal Letter at 10.

## VI. MOTION TO REJECT FILING AND PROTEST

On October 31, 1997, PG&E filed fourteen RMR agreements to provide services to the ISO, including the provision of energy and ancillary services from the Oakland unit. The services that PG&E provides to the ISO help to ensure that the ISO can operate

the ISO Controlled Grid in a reliable manner. In July 1997, the ISO Governing Board designated Oakland and Moss Landing as must run units. In late 1997, PG&E and Duke entered into an agreement by which PG&E agreed to sell three of its generating units to Duke. As such, Duke was well aware prior to purchasing the facilities that Oakland and Moss Landing were must run units. On April 24, 1998, Duke filed its RMR agreement and rate schedule for the Oakland unit in this proceeding.[4]

However, Duke's proposed RMR Agreement is not substantially similar to the ISO's RMR agreement with PG&E. Thus, as discussed below, the ISO is requesting that the Commission reject Duke's filing. The ISO will also request that the Commission deny PG&E's request to terminate service to the ISO. In the alternative, should the Commission not grant the ISO's request to reject the filing, the Commission should order the maximum suspension of five months. This suspension will coincide with the suspension and expedited hearing on PG&E's Notice of Termination.

The ISO cannot operate the ISO Controlled Grid in a reliable manner with 117 separate RMR agreements to cover the 117 separate RMR units. There must be some uniformity in the terms and conditions of those agreements. PG&E's current RMR agreement for Oakland specifically provides that the contract can be transferred only if the new terms and conditions are "substantially similar." Duke's proposed terms and conditions are not substantially similar to the PG&E agreement. If the Commission accepts for filing Duke's proposal with its disparate terms and conditions, it will be sending the message that all RMR unit owners can file any terms and conditions and tie up the ISO's resources with needless litigation and at the same time jeopardize the reliability of the California transmission system. The Commission should therefore either

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4 On April 24, 1998, Duke filed the RMR agreement for the Moss Landing unit.

reject Duke's filing as a matter of public policy or, the Commission should reject the Duke filing because Duke has not complied with the transfer provisions in PG&E's contract. At the very least, the Commission should suspend the filing for a full five months and set for expedited hearing whether a termination and transfer to an entity with different terms and conditions is in the public interest and is otherwise just and reasonable, deferring acceptance of Duke's filing until the issue is resolved.

The Commission has often suspended notices of termination for a full five months and ordered expedited hearings. *See Potomac Elec. Power Co.*, 43 FERC ¶ 61,189 (1988) (termination would reduce liability of service); *Ohio Power Co*., 8 FERC ¶ 61,210 (1979) (termination would make emergency service uncertain); *Montana-Dakota Utils. Co*., 44 FERC ¶ 61,327 (1988) (termination would have serious adverse effect on party's operations); and *Otter Tail Power Co*., 55 FPC 3817 (1976) (termination would have serious impact on electric service within the region).

Also, before service under a filed rate can be terminated, the termination must be shown to be in the public interest. *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414 (1952). The Commission has found that where a notice of termination would have impacts contrary to the public interest, it would not approve such terminations unless satisfactory alternative service is provided. In *Florida Power & Light Co.*, 8 FERC ¶ 61,121 (1979), the Commission rejected restrictive service availability proposals and two notices of termination that were based on those proposals. In those proposals, Florida Power & Light sought to exclude from its new partial requirements service those customers that had sufficient generating capacity to meet their loads. The Commission found that the proposals, and, consequently, the terminations, would eliminate the only practical source of baseload power to competing utilities within the markets dominated

by the company and, therefore, were anticompetitive. Similarly here, by permitting PG&E's notice of termination to take effect, the Commission would allow Duke to impose burdensome operational features that, due to the absence of competitive alternatives to Duke's RMR units, the ISO must accept. The Commission should forestall this result by suspending PG&E's Notice of Termination and deferring action on Duke's filing until a final Commission determination is made in PG&E's termination proceeding.

## A. PG&E Has Failed To Meet The Conditions Under Which Oakland May Be Conveyed.

### 1. Duke Has Failed To File An Agreement That Is Substantially Similar, As Required By PG&E's RMR Agreement

#### a. On Its Face, The Structure Of The Agreement Is So Fundamentally Different In Form That It Cannot As A Matter Of Law Be Found To Meet The Condition Precedent To A Sale

As the purchaser of RMR services from 117 separate units—services the ISO requires to maintain the reliability of the system—the ISO requires a uniform *pro forma* RMR agreement to ensure equity and ease in administration and consistency in cost determination. The word "uniform" does not imply that each RMR unit must have identical costs, identical performance characteristics and identical service limits. Given the large portfolio of RMR units under the ISO's control—117 hydro, geothermal, steam turbine and gas turbine units ranging in size from less than 1 MW to over 700 MW—the contracts cannot be literally the same. The RMR contract schedules, where the costs, performance characteristics and service limits of the units are listed, are sufficiently detailed to allow for differences among units. However, uniformity in the RMR context does mean that the costs, performance characteristics, service limits and obligations of

both the RMR Owner and the ISO in all the contracts must be determined—and administered—in the same way.

According to PG&E's RMR Agreement "A", section 2.2(a)(iii):

> This Agreement may be terminated by Owner, if it sells the Facility to a purchaser who, if ISO requires the Units to continue to be available, executes a contract with ISO or files a rate schedule with FERC to provide ISO the right to purchase Energy and Ancillary Services from the Unit under substantially the same terms as this Agreement (including terms specifying cost based rates, subject to the provisions of Section 5.7 of the Master Must Run Agreement). Such termination may not take effect prior to the effective date of all necessary regulatory approvals, including acceptance by FERC of the contract between ISO and the purchaser of the rate schedule filed by the purchaser.

The ISO will not execute or support a rate schedule filed with FERC by a new owner that does not include substantially the same terms and conditions as the contract being replaced. Having substantially the same terms for all RMR Agreements is very important for the ISO to operate Reliability Must Run services efficiently and effectively. That condition of uniformity was included specifically to avoid forcing the ISO to litigate terms and conditions each time a unit owner chooses to file a completely new agreement—in particular when an agreement is so different it cannot be redlined against the predecessor and requires 12 pages just to summarize the differences (*see* Attachment A).

"Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid." *Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir.), *cert. denied*, 414 U.S. 1068 (1973). In a similar vein, the Commission has found that the "rejection" of a filing " may be used by an agency where the filing is so patently a nullity as a matter of substantive law, that administrative efficiency and justice are furthered by obviating any docket at the threshold rather than

opening a futile docket." *Municipal Light Boards v. FPC,* 450 F.2d 1341, 1346 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 989 (1972).[5]

Here, the contract filed by Duke is a nullity and, therefore, the rate filing should be summarily rejected. The contract filed by Duke is contrary to the contractual obligations of the parties because the contract is not "substantially similar" to the contract between PG&E and the ISO. That contract provides that PG&E may not terminate the RMR contract at issue, unless the RMR contract filed by the purchasers is substantially similar to the contract between the ISO and PG&E. *See* PG&E's RMR Agreement "A" section 2.2 (a)(ii). As is shown in Attachment A, there are numerous substantive differences that show that Duke's proposed contract is not substantially similar to PG&E's and, therefore, is contrary to contractual obligations and invalid. *See also Ohio Edison Co.*, 43 FERC ¶ 61,316, at 61,882-83 (1988) (summarily rejecting a rate filing because it was contrary to a previous settlement agreement and, thus, a nullity);[6] *Union Elec. Co.*, 51 FERC ¶ 61,083, at 61,185-86 (1990) (rejecting a change to a tariff that

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[5] The PG&E RMR agreement that is on file with the Commission is the agreement that governs the service between PG&E and the ISO. That agreement was filed by PG&E. Although not a contract between the parties, PG&E must nevertheless comply with the terms of that agreement, including the termination conditions until the Commission accepts a superceding agreement. This situation is not unlike a *Mobile-Sierra* filing. The Supreme Court has held that if a public utility, subsequent to entering into a contract, unilaterally files with the Commission under section 205(d) of the Federal Power Act, a new tariff inconsistent with its contractual obligations, the newly filed tariff is a nullity and does not abrogate or supersede the contract. *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 338 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (expressly adopting *Mobile*'s reasoning). The D.C. Circuit has found that the rule of *Mobile-Sierra* is "refreshingly simple"—"[t]he contract between the parties governs the legality of the filing." *Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir. 1973).

[6] In *Ohio Edison*, the Commission summarily rejected the rate filing even though it had to interpret an ambiguity in the settlement agreement through the use of extrinsic evidence.

would restrict service based on retroactive criteria as clearly not reasonable because customers must have the opportunity to consider the consequences of changes and make rational planning and operating decisions of their own).

This issue has already been argued and briefed by the parties to the California RMR proceedings. The Chief ALJ has likewise recognized the need for uniform terms, *over the objections of the utility sellers.* The Chief ALJ specifically found that "[t]he simultaneous existence of different sets of terms of [sic] conditions by various owners can lead to confusion, uncertainty, and inefficiency." *Southern California Edison Co.,* 82 FERC ¶ 63,011, at 65,024 (1998) (citing the Commission's rejection of different open access tariffs). Several parties supported the Commission Trial Staff's motion to sever the terms and conditions, such as the Public Utilities Commission of California, Cogeneration Association of California, the California Independent Energy Producers and—Duke.[7]

**b. Without The *Pro Forma* Agreement, Reliability Is At Risk**

The ISO's RMR structure was carefully crafted to recognize the need for uniformity of these agreements. The conditions under which an RMR Agreement may be assigned (only with ISO consent) or a unit conveyed and a new agreement filed (only on similar terms with the new owner and with the additional protection that any initial rate must be found just and reasonable before it is allowed to go into effect) are policy choices made by the California market participants and known by Duke when it committed to the

[7] Parties opposing the creation of a separate terms and conditions proceeding included Houston Industries, PG&E, SCE, SDG&E, Sacramento Municipal Utility District, the Cities of Anaheim, Colton and Riverside, California, and the Cities of Azusa and Banning, California (Southern Cities) and El Segundo Power, LLC.

purchase. Moreover, these are reasonable conditions that are fundamental to the ISO being able to operate reliably.

Allowing each RMR contract to specify different communications protocols, timing and structure of Dispatch Notices, the conditions under which the ISO may call upon the units or the conditions under which the units would be required to furnish service, would wreak havoc with ISO operations.[8] ISO dispatchers would have to treat each RMR facility differently and either develop photographic memories of each separate RMR contract or be forced to consult each Unit's contract before every RMR transaction—an impossible task when trying to dispatch units in real time.

In order to carry out its reliability responsibilities, the ISO must be able to call upon an RMR unit when it needs it, and, because such needs often arise from unforeseen events (such as the loss of transmission lines), call upon the unit with little or no advance notice. In addition, the ISO must be able to call upon the unit using uniform, simple terms. Any unit-prescribed differences in ISO-unit communications introduce complexity, and, when real-time reliability is at stake, complexity introduces delay, and inaction resulting from delay will adversely impact reliability.

Moreover, the unit must provide service when called upon. The RMR units are one of the ISO's primary tools in maintaining system reliability. For some system problems, they are the ISO's only tool. If the unit's owner has the right to provide service only under that unit's individual terms, the ISO may not have guaranteed access to the services of that unit.

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[8] Consistent with the Chief ALJ's views, the ISO also favors a uniform approach to calculating rates. As such, the ISO supports a formula rate for RMR service. As the Commission is aware, formula rates consist of inputs which then vary on a yearly basis as the various cost inputs change. The ISO does not want to go through the time and expense of litigating RMR rates every time the inputs change, or new owners come on board. Such an approach is consistent with Commission precedent. *See, e.g., Middle South Services, Inc.*, 16 FERC ¶ 61,101, at 61.219 (1981).

The process the ISO goes through when dispatching RMR units simply will not lend itself to a myriad of terms and protocols. In advance of the operating day the ISO must:

- Project loads and other operating conditions;
- Determine what the system's reliability needs are based on those projections;
- Determine what combinations of units are needed to meet those reliability needs;
- Evaluate what energy and Ancillary Service needs have been met through the market after the market closes;
- Determine the most cost-effective way to use RMR units to meet the reliability needs that the market has not provided;
- Ensure that the RMR units are being utilized within their contract constraints (e.g. service limits, operational restrictions on start-ups and ramps);
- Prepare the loading instructions for the RMR units, and distribute them to the units' Scheduling Coordinators.

During the operating day, the ISO must:

- Monitor the system to ensure the day-ahead RMR schedules are being met;
- Follow the system conditions to ensure real-time reliability needs are being met;
- Where they are not, either due to inaccurate forecasts or unplanned outages, determine the new reliability needs;
- Gauge how real-time market bids may be used to address real-time changes in reliability needs;
- Determine the most cost-effective way to use RMR units to meet the reliability needs that the market has not provided;
- Ensure that the RMR units are being utilized within their contract constraints (*e.g.*, service limits, operational restrictions on start-ups and ramps)
- Prepare the loading instructions for the RMR units and distribute them to the units' Scheduling Coordinators.

All the actions listed above for both time frames—before and during the operating day—must be logged to allow for proper payment, audit and dispute resolution.

As the two lists above indicate, dispatching RMR units within the overlapping frameworks of market auctions and RMR contracts is a complex process. Without uniform RMR contracts, the system operator would have to consult each individual contract before calling on that unit to provide service to ensure the ISO was complying with the terms and conditions of that contract. This would inevitably create delays, and since RMR units are, by definition, those units that must run to ensure system reliability, the potential price to be paid for any delays within these processes is the loss of system reliability.

The ISO is charged with maintaining system reliability, but is charged with doing so at the least possible cost, so as to benefit its broadest constituency—the ratepayers of the State of California. Except for in the most dire of emergencies (emergencies which the ISO will diligently strive to avoid through the proper, pro-active dispatch of RMR units), the ISO cannot separate the costs of RMR units from the reliable dispatch of RMR units. To suggest something else can be done is to turn the restructuring of California's electric industry into an "at-all-costs" exercise, which is the exact opposite of what that restructuring was meant to accomplish—a reduction in the overall of cost of reliable electric production and distribution. Thus it is essential that Duke's RMR Agreement be made to conform to the other Must-Run Agreements.

#### c. Without The *Pro Forma* Agreement, Costs Will Increase

In addition to the risk to reliability, there are significant risks to the ISO's ability to minimize the cost of RMR services through its annual selection of RMR units. For example, the ISO's goal is to reduce and ultimately eliminate the need to call on units under the RMR contracts to manage system reliability. To do so, the ISO will have to be

able to assess both the effectiveness and the cost of alternatives to RMR contracts, such as new transmission or new generation resources. The ISO requires the RMR contracts to be structured uniformly so the cost-effectiveness of RMR generation can be properly compared—both against other RMR units, and against other generation and transmission alternatives.

Likewise, to minimize the cost of reliability to each transmission owner's ultimate customers, the ISO will need to dispatch RMR units as efficiently as possible. If the service limits, performance characteristics and costs of RMR units are not specified according to uniform criteria, it will be difficult for the ISO to compare the effective costs of RMR units, and therefore difficult to dispatch them in the most economic fashion.

Moreover, if RMR units are not compensated the same way for providing the same service, the potential for disputes is enormous. The ISO would have to calculate all RMR charges manually, which opens the door to errors. Otherwise, the ISO would have to develop and maintain complicated software to associate the right compensation methodology with each unit. Non-uniform contracts could logically lead to non-uniform invoices for RMR services, which would greatly complicate the efforts of the ISO Settlements staff trying to validate RMR Owners' invoices with the ISO's dispatch records.

#### d. The Substantive Terms Of The Agreement Are So Fundamentally Different That The Agreement Cannot As A Matter Of Law Be Found To Meet The Condition Precedent To A Sale

The substantive terms of the Duke filing are fundamentally different from the terms and conditions in the PG&E agreement, and are, therefore, in violation of the

assignment clause in the PG&E agreement. As such, Duke's filing should be rejected.

For example,

- Duke seeks a Letter of Credit from the ISO. The ISO is prohibited from issuing this Letter of Credit by the Reimbursement Agreement, in Article VII (Negative Covenants of the ISO), Section 7.2 (Limitations on Additional Debt). Any breach of this covenant would be an event of default in the Reimbursement Agreement, Article VIII (Defaults and Remedies), Section 8.1c (Events of Default).

- Duke retains the right to suspend service for non-payment. There is no such right in the other RMR Agreements and, in fact, this alone creates a major reliability issue given PG&E's refusal to agree to pay under dispute.

- Duke has changed the way "Owner's Deemed Costs" are calculated for the B contract.

- The definition of *force majeure* would excuse Duke from mechanical breakdowns. The ISO believes that equipment failure belongs in the forced outage rate calculation.

- Duke's termination provision would not bind a new owner to file a contract under substantially the same terms.

- Duke would be able to move to the "B" contract 90 days from ISO operation, without notice. Currently an owner must give 90 days notice. This allows Duke to weigh market risks right up to a conversion.

- Duke provides a right to roll *back* to "A" at the start of a new year. The PG&E contract would limit conversion to once a year and require rollover on whatever version the unit is on at the end of the previous year. Duke also provides for more frequent changing from B to A and *vice versa* and with 30 days notice, not 90.

- Duke has added an *obligation* on the ISO's part to issue dispatch notices, rather than the permissive language in PG&E's version. This creates a materially different liability for the ISO.

- Duke has materially altered the schedules governing what happens if the ISO needs to issue a dispatch notice above the various limits and has included *monthly* service limits. Given the uncertain nature of the RMR need in the initial years, any further limitation could have significant cost and reliability implications. Duke also adds a new limit for "maximum hourly generation."

- Duke added a 2% margin for error for reliability testing.

- Duke has significantly limited the ability of the ISO to deny capital expenditures. Since the ISO is obligated to pay an exit fee for unrecovered capital expenditures, this could substantially bias any evaluation of alternatives to Duke's RMR units.

- Duke has lowered its obligation to "reasonable efforts" from "best efforts" in a number of places. This allows Duke to consider economics in deciding whether to comply with the ISO's directive.
- Duke seeks coverage under the ISO's errors and omissions insurance policy.
- Duke has limited the period in which the ISO can audit Duke's books.
- Duke has significantly altered the indemnification provisions.

Other provisions of Duke's RMR Agreement that are substantially different from PG&E's RMR Agreement are set forth in Attachment A.

If the Commission accepts this filing, it will set precedent for future RMR owners who may want to file their own versions of the RMR Agreement. *The ISO cannot operate with a multitude of different RMR Agreements while litigating with parties before the Commission to determine what version of a contract ultimately should be utilized to operate the ISO's Reliability Must Run obligation*. Public policy supports a *pro forma* RMR Agreement with uniform conditions and agreements for all owners. These public policy concerns and the balance against current RMR owners are being addressed in the current RMR settlement negotiations. That proceeding should determine the terms and conditions for any owner buying RMR units.

#### e. The ISO Faces Substantial Additional Costs And Risks Associated With Its Financing If The Commission Accepts Duke's Filing

The ISO's ability to obtain financing has been dependent on its ability to mitigate the risk that it would owe RMR unit owners amounts due for RMR service but be unable to collect those amounts from the applicable transmission provider. When the ISO first sought financing, no bank was willing to lend to the ISO unless the ISO's obligation to RMR unit owners was "non-recourse"—payable solely out of amounts collected from the relevant transmission provider. So long as the transmission provider also is the RMR

unit owner, the ISO has the equivalent of a non-recourse obligation since there is an express right of set-off of amounts due to the unit owner with amounts due from the affiliated transmission owner.

The RMR unit owners purchasing the SCE plants, SCE, and SDG&E have agreed to equivalent non-recourse liability in a "Principles of Agreement." Tariff and contract language is being drafted to accomplish that agreement in principle.[9] PG&E's January 29, 1998 filing included similar language, but PG&E withdrew that provision in an *"errata"* notice filed March 6, 1998.

Before any PG&E units were sold and on the strength of the SCE and SDG&E agreements in principle and an expectation that an agreement with PG&E could be reached, the ISO, in consultation with its lenders, arranged for the sale of $301,400,000 in tax-exempt variable rate demand bonds issued by the California Economic Development Financing Authority and backed by a letter of credit issued by Bank of America National Trust and Savings Association (BofA). The first issuance of $101,600,000 was sold May 5, 1998. The second issuance of $199,800,000 is scheduled for May 15, 1998. Because BofA provides the credit support, the ISO's representations, warranties, and continuing covenants are principally to BofA through the Reimbursement Agreement. The Reimbursement Agreement provides the following in Article VII, Negative Covenants of the ISO, Section 7.9, Must Run Agreement Units:

> SECTION 7.9 Must-Run Agreement Units. The ISO shall not designate a unit as a Reliability Must-Run Unit as provided in Section 5.2.3 of the Tariff unless (i) the Owner of such unit has agreed that it has no recourse to the ISO in respect of any Reliability Must-Run Charge in the event the ISO has not received the Reliability Must-Run Charge from the applicable PTO (a "Pay When Paid RMR") and (ii) the applicable PTO has agreed

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[9] Changes will be made to ISO Settlement and Billing Protocol Annex 1, Settlement and Billing of Reliability, Must-Run Charges and Payments.

> that it will pay to the ISO all Reliability Must-Run Charges invoiced to the PTO in respect of such Reliability Must-Run Unit without setoff; provided, however, that such agreement may allow such PTO to make such payment under protest and to obtain a refund, with interest, of any invoiced amount determined not to have been due and payable, which refund (with interest) shall be netted against future payments from such Owner.

Duke's contract would result in a breach of the above covenant and trigger an event of default. The Reimbursement Agreement provides that a violation of Section 7.9 is an event of default under Article VII, Section 8.1.c. As such, it is materially different from the PG&E agreement in its effect on the ISO and thus fails to meet the condition for sale of an RMR unit.

BofA has advised the ISO that if PG&E refuses to agree to principles of agreement substantially similar to those agreed to by SDG&E, SCE and the SCE unit purchasers, and FERC accepts Duke's filing and permits it to become effective, BofA will:

- impose substantial restrictions on the use of the proceeds of the second issuance;[10]
- create a term loan for the $69,245,000 of disbursements for working capital and completion of infrastructure at a substantially increased interest rate that is payable over one year in 1999, rather than ten years;
- require that the funds not disbursed would be used to provide collateral for the Letter of Credit and to redeem the outstanding bonds

These lending restrictions exist because the potential liability of the ISO for RMR payments is very large relative to its overall operation budget. For example, the total for

[10] Before the ISO issues its second issuance the BofA has required the ISO to execute an amendment to the Reimbursement Agreement providing severe limitations on the use of bond proceeds until "such time . . . as . . .the Banks have received from the ISO and Pacific Gas and Electric Company ("PG&E") a fully executed agreement in form and substance satisfactory to the Issuing Agent, the Agent and the Banks regarding the sale by PG&E of its Reliability Must-Run Units." Reimbursement Agreement, Amendment 1, Section 6.13.

must-run services during a peak season month alone could total $152.7 million, an amount equal to the ISO's annual operating budget. The RMR Agreements are estimated at costing more than $1.5 billion for 1998. The ISO estimates the potential financial impact of these restrictions to be between $2 and almost $4 million in increased interest costs. In addition, the ISO will be required to make payments that could increase the Grid Management Charge by approximately $0.4872/MWh for 1999 to repay the one-year term loan if PG&E and Duke impose their terms on the ISO.

This potential cost increase can be wholly avoided if PG&E retains ownership of the units. All but about $800,000 in increased borrowing costs can be avoided if PG&E agrees to the "Principles of Agreement" already agreed to by SDG&E, SCE and the SCE owners. The ISO respectfully submits that any filing putting the ISO in such a materially adverse financial situation is facially inadequate to meet the conditions of PG&E's RMR Agreement on sale of the unit.

### B. The Duke Agreement Should Be Rejected And Not Accepted Even With A Refund Condition.

A purchaser that does not agree with an initial rate should not be unilaterally forced to take service under it. As the above discussion indicates, the Commission, for both legal and policy reasons, should reject this filing. As to Duke's contention that the filing is an initial rate, at a minimum, an initial rate contemplates arms length bargaining between the parties. *Middle South Energy*, 23 FERC 61,277, at 61,572 (1983), *order on remand,* 31 FERC ¶ 61,304, at 61,627, *reh'g denied*, 32 FERC ¶ 61,223, at 61,510 (1985). Here, the ISO attempted to negotiate with Duke prior to its filing. However, Duke unilaterally terminated those negotiations and made this filing. The Commission should not allow such an approach. The Commission should protect the ISO, a captive customer in the receipt of must run service, by rejecting the filing.

More importantly, the Commission should also not just accept the filing, suspend it and make the filing subject to refund. The Commission's refund and suspension authority will not protect the ISO in these circumstances. The ISO has documented the harm, both operationally and financially, that will occur if Duke's unilateral filing is accepted subject to refund. The ISO simply cannot operate the transmission grid in a reliable fashion if unilateral filings are accepted and allowed to be in effect for a substantial period of time before those filings are found just and reasonable.

The Commission has taken steps in other situations when its refund and suspension authority will not protect captive customers. This is that situation. For example, if a transmission provider seeks market-based rates, the Commission will not grant market-based rate authority until the market power of that transmission provider is mitigated by offering comparable open access transmission. The Commission will not allow transmission providers to exercise market power while the lengthy hearing process unfolds. *Kansas City Power & Light Co.*, 67 FERC ¶ 61,183 (1994); *Kentucky Utils. Co.*, 71 FERC ¶ 61,250 (1995). So too, the Commission will not accept modifications to the Commission's open access tariff unless the transmission provider proves that the modified terms and conditions are equal or superior to the Commission's open access tariff. *Northern States Power Co.*, 83 FERC ¶ 61,098 (1998), *citing New York State Elec. & Gas Co*., 78 FERC ¶ 61,114 at 61,434-35 (1997), *reh'g denied*, 82 FERC ¶ 61,209 (1998). The Commission will not let parties use the Commission's practice of acceptance, suspension and a hearing process that often can be lengthy, to frustrate open access transmission.

The case of *KN Interstate Gas Transmission Co. (KNI)* clearly states why. 68 FERC ¶ 61,401 (1994). There, an interstate pipeline made a Section 4 rate filing, the

companion to the Section 205 filing Duke made here, seeking authority to charge market based rates. KNI wanted the Commission to accept and suspend the filing so that it could charge market-based rates pending the outcome of the hearing. The Commission said no. The Commission stated:

> In the instant case, KNI has not shown that it lacks significant market power. It is clear that certain customers are connected solely to the Buffalo Wallow System. These customers have no good alternatives, and the Commission concludes that KNI has not proposed safeguards that will adequately protect these captive customers.

The Commission added:

> In this instance where the proposal lacks adequate safeguards to protect captive customers, the Commission cannot fulfill its duty to protect those captive customers if it accepts and suspends the proposed tariff sheets. The maximum suspension period of five months is unlikely to be adequate time for the Commission to analyze possible revisions to KNI's proposal to ensure that adequate protective measures could be crafted that would ensure just and reasonable rates for these customers. Therefore as discussed in greater detail, the Commission finds that it *must* reject the proposed tariff sheets.[11]

The circumstances surrounding the ISO are the same. The ISO is a captive customer for RMR services. Duke must provide such services to the ISO if the grid is to operate in a safe and reliable fashion. There are no alternatives. Yet, Duke has made a unilateral filing with terms substantially different from the terms in the ISO's contract with PG&E. Duke's filing, if accepted, would not allow the ISO to operate efficiently and could affect the ISO's obligation to provide reliable transmission service. Duke has proposed nothing to mitigate market power. Moreover, the Chief ALJ's goal of standard terms and conditions for RMR service may not be completed during the five month

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[11] *KNI*, 68 FERC ¶ 61,401, at 62,587-88 (1994) (emphasis added). *See also Natural Gas Pipeline Co. of America*, 41 FERC ¶ 61,358 (1987) (order rejecting gas inventory charge filing finding that if filing is accepted without reviewing the terms, Commission could not put parties in same place as if proposal had never been filed).

suspension period. Therefore, the Commission should reject the Duke filing and require PG&E to provide RMR service under the currently effective tariffs, pending the successful completion of negotiations on standard terms and conditions for must run service. Only by taking this approach will the Commission protect the ISO, a captive customer for RMR services.

### C. Substantial Public Interest Issues Warrant the Commission's Scrutiny and Use of Conditioning Authority Under Section 203 of the Federal Power Act.

Important public interest considerations dictate that the Commission should require PG&E and its successor in interest, Duke, to file under Section 203 of the FPA for authority to transfer jurisdictional assets and demonstrate that, on balance, the proposed transfer is consistent with the public interest. The Commission has well-established authority to treat the proposed transfer as subject to the requirements of Section 203. The energy from the Oakland facility is clearly being sold into a commingled supply of electrons, some of which are delivered in sales for resale in interstate commerce. Since 1942, both the records and other accounts related to such transactions, as well as the generation facilities from which the sales are made, have been characterized as jurisdictional facilities. *Hartford Elec. Light Co. v. FPC,* 131 F.2d 953, (2d Cir. 1942), *cert. denied*, 319 U.S. 741 (1943). The Commission has repeatedly relied on this precedent to determine when to assert jurisdiction over sales for resale in interstate commerce. *See Enron Power Marketing, Inc.,* 65 FERC ¶ 61,305 (1993) and *Louis Dreyfus Elec. Power, Inc.,* 62 FERC ¶ 61,234 (1993). The Commission has also relied on the *Hartford* decision to justify consideration of whether a merger or other transfer of jurisdictional facilities is consistent with the public interest. *See San Diego*

*Gas and Elec. Co. v. Alamito Co.,* 38 FERC ¶ 61,241 (1987) and *Enova Corp. and Pacific Enterprises,* 79 FERC ¶ 61,107 (1997).

Recently, the Commission approved a sale of generation and related transmission assets from New England Power Company and others to U.S.Gen. New England, Inc. *New England Power Co.,* 82 FERC ¶ 61,979 (1988). In that order, the Commission carefully reviewed the effects that the transfer, part of the overall restructuring of the New England electric industry, would have on the public interest, including the effects on competitors rates, regulation and other issues. No less is required by the transaction at issue in this proceeding. As a key component of California restructuring with a significant potential effect on future electric operations, this transaction requires a full public interest scrutiny.

There are compelling public interest reasons why the Commission should assert its Section 203 jurisdiction and not approve an unconditioned transfer of facilities from PG&E to Duke. First, these facilities are critically situated and by definition have market power under certain operating conditions since the ISO has no alternative but to call on these facilities during those conditions to ensure the reliable operation of the transmission system. Thus, the public interest requires that operational terms and conditions be attached to the transfer to limit the exercise of that market power to electric consumers. Secondly, these generation facilities operate to support and substitute for transmission service. As the reliable operation of the transmission system is necessary for the provision of electric service and the development of competitive energy markets, the Commission must also act to ensure that the owners of these facilities reasonably coordinate their operations with the operation of standard transmission facilities. The whole thrust of recent regulatory efforts by the Commission has been to require that the

owners of facilities needed for transmission service make those facilities available for use by others on reasonable terms and conditions. If Duke will not agree to terms that are needed to provide the reasonable coordination and uniformity needed by the ISO, then the Commission should exercise its Section 203 authority over the transfer of jurisdictional facilities to impose such conditions on the transfer. At the very least, the Commission should require that Duke be required to operate under the existing terms and conditions filed by PG&E until Duke has established that its non-conforming terms and conditions are consistent with the public interest.

## VII. FURTHER PROTEST - DUKE'S REQUEST FOR WAIVER OF SECTION 35.13 FILING REQUIREMENT SHOULD BE REJECTED.

If the Commission accepts Duke's filing, it should reject Duke's request for waiver of the Section 35.13 filing requirements. 18 C.F.R. § 35.13. Duke claims that, because it has had no cost experience with the Oakland facilities, it is unable to provide the required base period data, and requests waiver of the Section 35.13 filing requirements. April 24, 1998 Transmittal Letter at 9. According to Duke, if the Commission finds that its filing constitutes a change in rate, the Commission must also conclude that its rate revision is being made to PG&E's rates. April 24, 1998 Transmittal Letter at 8-9.

Duke has offered no valid reason why the Commission's filing requirements should be waived. The Commission and the other parties need Duke's Section 35.13 data in order to adequately evaluate the reasonableness of its filing. Duke can use PG&E's historical data to develop its own cost projections if it deems such use appropriate. However, if Duke chooses to rely on PG&E's data, it should not be relieved of the burden of showing that its rates are just and reasonable.

Duke also states that "no officer or other official of [Duke] can make the representations regarding historical data which officers of PG&E have proffered." April 24, 1998 Transmittal Letter at 8. This statement is misleading. Section 35.13 of the Commission's regulations do not require Duke to affirm PG&E's historical data; rather, the regulations set forth the data that Duke itself is required to provide in a change in rate filing. The Commission should therefore deny Duke's request for waiver of the Commission's filing requirements.

## VIII. CONCLUSION

Wherefore, based on the foregoing, the ISO respectfully requests the Commission to permit the ISO to intervene and be treated as a party to this proceeding with all rights appropriate to that status, and request the Commission to duly consider the protest, and grant the ISO's motions for rejection and consolidation filed herein.

Respectfully submitted,

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Date: May 14, 1998

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the forgoing document upon each person designated on the official service list compiled by the Secretary in this Docket No. ER98-2669-000, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (1997).

Dated at Washington, D.C. on this 14th day of May, 1998.

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Linda L. Walsh