

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

Morgan Stanley Capital Group Inc.)	
v.)	Docket No. EL01-89-000
California Independent System Operator)	
Corporation)	

**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION TO COMPLAINT BY MORGAN STANLEY CAPITAL GROUP**

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2000) and the Commission's notice of filing dated June 15, 2001, the California Independent System Operator Corporation ("ISO")¹ hereby submits its Answer to the complaint filed by Morgan Stanley Capital Group Inc. ("Morgan Stanley").

"Phantom Congestion" is caused by the ISO's requirement to honor, and reserve transmission capacity associated with, Existing Contracts under the ISO Tariff and previous Commission orders. Existing Contracts often contain scheduling timelines that are different from the ISO's Day-Ahead and Hour-Ahead scheduling timelines. In order to honor these Existing Contracts, transmission capacity is reserved in the ISO's Day-Ahead and Hour-Ahead scheduling processes but often is not used by the holder of such Existing Rights in real-time. These Existing Contract reservations cause paper or so-called "phantom" congestion. While the ISO can use in real time any transmission

¹ Capitalized terms not otherwise defined herein shall have the meaning as defined in the Master Definitions Supplement, Appendix A to the ISO Tariff.

capacity that has not been scheduled by the holder of Existing rights in the Hour-Ahead scheduling process, the reserved and unused transmission capacity is not available for use by Market Participants in the ISO forward markets (i.e., the Day-Ahead and Hour-Ahead scheduling processes).

As discussed herein, the ISO agrees with Morgan Stanley that the problem of phantom congestion needs to be addressed expeditiously. Morgan Stanley's suggested solution, however, poses significant operational and administrative problems. Accordingly, the ISO proposes that the Commission adopt one of the ISO's proposals articulated in Docket No. EL01-47.

I. BACKGROUND

In its October 1997 Order conditionally authorizing operation of the ISO, the Commission required the ISO to accommodate Existing Contracts:

While we agree with the California Commission that it may be difficult for the ISO to accommodate the varied operational protocols and procedures of Existing Contracts, we view this as an unavoidable transitional problem. We believe that the temporary problem of accommodating the scheduling and operating practices of Existing Contracts under the ISO's rules and protocols is outweighed by considerations of not upsetting the benefits and obligations of Existing Contracts, which were established over many years.

Pacific Gas & Electric Company, et al., 81 FERC ¶ 61,122, 61,470-71. The Commission rejected the ISO's proposal to deny Non-Converted Rightsholders the opportunity to exercise their within-the-hour scheduling rights under Existing Contracts.²

² *Id.* at 61,471. The Commission also noted that its decision did not affect any rights that parties may have to seek case-by-case modification of Existing Contracts under section 205 or

The arrangement that was established, due to concerns that the ISO would misinterpret Existing Contracts, is that the ISO is not permitted to interpret these contracts but must respect the operating instructions provided to it. If operating instructions can be mutually agreed to by the Existing Contracts parties, then those are the instructions the ISO must follow. To the extent that the Existing Contract parties can not agree, then the ISO is required to follow the operating instructions provided by the Participating Transmission Owner. See ISO Tariff at 2.4.4.4.1.1. The ISO has no say in the instructions and does not have the ability to disregard them.

Additionally, to facilitate the honoring and scheduling of Existing Contracts, the ISO has executed Responsible Participating Transmission Owner Agreements ("RPTOA") with Southern California Edison Company ("Edison") and Pacific Gas & Electric Company ("PG&E"). The RPTOA requires Edison and PG&E to act as Scheduling Coordinators on behalf of their respective Existing Rightsholders.³

In its Order concerning Amendment No. 27 to the ISO Tariff, however, the Commission clearly recognized the problem of phantom congestion within the ISO Controlled Grid:

This term, as explained by the ISO, relates to the scheduling timelines afforded to current G[overnmental] E[ntitie]s under Existing Rights contracts which are different and not entirely compatible with the day-ahead and hour-ahead schedules that the ISO operates under. Because the Existing Rights contracts allow scheduling changes after the ISO scheduling deadlines, available

206 of the Federal Power Act. *Id.* at 71,471 n.192.

³ See Offer of Settlement accepted in Docket No. ER98-1057-000, *et al.*

transmission capacity remains unutilized. According to the ISO, an after-the-fact review of actual data from December 1998 to November 1999 indicates that in many days the congestion on contract paths was less than anticipated because the holders of Existing Rights did not fully utilize those rights, but that information was not available in real-time to the ISO to allow the market to respond. Thus, the ISO states that, if there were immediate conversion of Existing Rights to FTRs for new Participating TOs, this "Phantom Congestion" would be eliminated.

A number of GEs argue that: (1) "Phantom Congestion" is a valuable scheduling right of the GEs; (2) the ISO is at fault for failing to develop software to accommodate these rights nor recognize the operational realities of full service utilities; and (3) the requirement that Existing Rights be converted to F[irm] T[ransmission] R[ights] to alleviate the purported "Phantom Congestion" is a step backwards inasmuch as the ISO currently allows a five year conversion period during which time a party to an Existing Contract can become a new Participating TO and continue to exercise their contract rights. Additionally, some GEs have suggested that the appropriate place to deal with this issue may be the stakeholder process now under way in the ISO congestion management program.

We do not agree with the position taken by the GEs. Software that perpetuates the non-conforming schedules will not fix this problem of "Phantom Congestion." We believe that this approach simply suggests an iterative scheduling process that will not allow sufficient time for the market to respond and will leave the ISO with insufficient time to manage the grid reliably. Furthermore, while GEs contend that their scheduling flexibility is a valuable asset, it results in overall market inefficiencies due to scheduling time lines that do not conform to the time lines of the overall markets. It is difficult to justify the scheduling flexibility advantage in light of the congestion these rights cause the ISO.⁴

The Commission found that phantom congestion was "a market inefficiency that must be addressed and rectified as quickly as possible" and stated that, if the issue was not resolved in the overall settlement negotiations concerning the

⁴ *California Independent System Operator Corporation*, 91 FERC ¶ 61,205 at 61,727 (2000).

ISO's transmission Access Charge, the Commission would "address it in a separate proceeding."⁵ Settlement discussions are ongoing in this proceeding.

On March 14, 2001, the Commission issued in Docket No. EL01-47 its Order Removing Obstacles to Increased Electric Generation and Natural Gas Supply In the Western United States and Requesting Comments On Further Actions to Increase Energy Supply and Decrease Energy Consumption.⁶ The Commission stated that in light of the severe electric energy shortages facing California, it had examined all of its rate and facility certification authorities to determine how it can help increase the supply of electric energy. The Commission also requested comments on whatever additional actions would be warranted.

On April 3, 2001 the ISO filed its response. The ISO noted that elimination of phantom congestion was one reform within the sole jurisdiction of the Commission that can enhance utilization of the transmission grid without the need for physical modifications. While the ISO, "recognize[d] the importance the Commission has placed on honoring Existing Contracts and that contract reformation is not to be undertaken absent the most compelling public interest," the ISO also understands that "there is an electricity crisis facing California and the other areas of the West and the problems in these areas arise, in part, from transmission constraints."⁷

⁵ *Id.*

⁶ 94 FERC ¶ 61,272 ("March 14 Order").

⁷ See ISO comments at 9 citing March 14 Order at 61,967-68.

Accordingly, the ISO offered two options for the Commission's consideration for resolving phantom congestion:

- 1) the Commission would reform the scheduling timelines of the Existing Contracts of the Participating Transmission Owners so that any service under these agreements would be scheduled with the ISO on a Day-Ahead basis. Thus, any capacity left unscheduled in the Day-Ahead Market would be available to the Hour-Ahead Market;⁸ or
- 2) the holders of Existing Contracts would be given Firm Transmission Rights ("FTRs") for Inter-Zonal Interfaces commensurate with their pre-existing capacity reservations.⁹ These FTRs would entail the same rights and obligations as those previously auctioned by the ISO and could be sold in a secondary market. Thus, the FTR holder would have a scheduling priority in the Day-Ahead scheduling process and would be entitled to receive a commensurate share of congestion revenues.¹⁰ Transmission capacity represented by FTRs that is not scheduled on a Day-Ahead basis would be released to the Hour-Ahead market. The Commission found a similar proposal for FTRs reasonable in the context of the ISO's transmission Access Charge.¹¹

On May 16, 2001, the Commission issued its Further Order On Removing Obstacles To Increased Energy Supply and Reduced Demand In The Western United States. 95 FERC ¶ 61,225. With regard to the issue of phantom congestion, the Commission reiterated:

that "phantom congestion" is a market inefficiency that must be addressed and rectified either through the settlement

⁸ If the Existing Contracts were reformed in a different manner such that an Existing Rightsholder had an ability to exercise its rights in the Hour-Ahead scheduling process (i.e., not schedule in the Day-Ahead process, but exercise its rights in the Hour-Ahead process), the ISO would likely be required to reserve the transmission capacity in both the Day-Ahead and Hour-Ahead markets. Thus, no additional capacity would be freed-up for the market.

⁹ In accordance with Article 9 of the ISO Tariff, the ISO makes FTRs available through periodic auctions. FTRs enable Market Participants to hedge their exposure to Inter-Zonal Congestion costs imposed through Usage Charges. FTRs entitle the holder to receive a share of the Usage charge revenues paid to the ISO.

¹⁰ See Sections 9.7 and 9.6 of the ISO Tariff, respectively.

¹¹ See *California Independent System Operator Corporation*, 91 FERC at 61,726-27.

negotiations regarding the ISO's transmission Access Charge, or in a separate proceeding.¹² While the phantom congestion issue is currently being addressed in overall settlement negotiations under Docket No. ER00-2019, the Commission will address phantom congestion in a separate proceeding in the event the negotiations do not resolve this issue.

Further Order On Removing Obstacles To Increased Energy Supply and Reduced Demand In The Western United States, 95 FERC at 61,773.

II. ANSWER

A. The Complaint Is Misdirected. Morgan Stanley Should Have Filed Against the Existing Contracts the ISO Is Currently Bound to Honor.

As the background analysis clearly demonstrates it is the Participating Transmission Owner, not the ISO, who is responsible for interpreting and scheduling the Existing Contracts. The ISO is concerned that Morgan Stanley's proposal would have the effect of placing the ISO between the Scheduling Coordinator and the entities it represents, forcing the ISO to make administrative determinations as to projected use and overriding the actual schedules submitted in accordance with the ISO Tariff. Moreover, the proposal adds a new problem – there is currently no mechanism for the Scheduling Coordinators acting on behalf of the holders of Existing Contracts to notify the ISO, within the operating hour, that the Existing Rightsholder does in fact wish to schedule its full allotment rather than the proxy allotment. Thus if Morgan Stanley desires to resolve the phantom congestion problem its complaint should be against PG&E and Edison for reformation of the Existing Contracts not against the ISO.

¹² See *California Independent System Operator Corp.*, 91 FERC ¶ 61,205 at 61,727 (2000).

B. The Specific Relief Requested By Morgan Stanley Is Unworkable. The Commission Should Adopt Either of the Prior Approaches Proposed By the ISO.

Morgan Stanley offers the following solution to the phantom congestion problem:

- (1) Assume that existing contract customers will use 150 percent of the average actual existing contract transmission schedules for the last 14 days for the given hour;
- (2) The rest of the TTC should be made available to Market Participants in the Day-Ahead; and
- (3) If existing contract customers actually schedule or use more capacity than the amount assumed in the reservation, Market Participants will be curtailed on a pro rata basis, with a corresponding refund to Market Participants.

This proposal does exactly what Morgan Stanley contends it doesn't. It infringes on Existing Contracts by assuming that 150 percent of the transmission capacity scheduled for the last 14 days is the amount of capacity that the Existing Rightsholder will schedule in the future, and that some sort of pro rata refund fully compensates the Existing Rightsholder for the loss of the contract capacity.

Second, the Morgan Stanley proposal would impose additional administrative costs on the ISO for system programming to accommodate the proposal's maximum schedule provision. Third, on going manual "work-arounds" would be required for the ISO to determine and settle refunds when and if any refunds are required as a result of an Existing Rightsholder exercising all of its rights under the Existing Contract that the Commission has ruled that the ISO must honor.

These are very real costs that Morgan Stanley is asking the ISO to bear.

There is also no indication in the Complaint that Morgan Stanley has in any way empirically tested their very arbitrary formula of turning capacity back to the market equal to 150% of that scheduled within the past 14 days. The ISO is unsure whether or not this formula is even close to the Scheduling practices of a number of Existing Rightsholders. The ISO does not know how often refunds would be required or how much additional capacity would actually be made available as a result of the proposal. In contrast, the ISO's proposed options ask the Commission to act to reform the scheduling provisions of these agreements such that either as Existing Contracts or as Firm Transmission Rights the transmission capacity contained in these agreements is fully available both to the holders of such Existing Rights and to the other Market Participants.

C. Morgan Stanley's Claim that the ISO Agrees With Their Proposal Is Inaccurate.

On page 11 of the complaint Morgan Stanley states "Moreover, the CAISO believes that this proposal is a viable option to providing interim relief from phantom congestion". In support of this proposition Morgan Stanley cites its own motion to file comments out of time in Docket No. EL01-47-001, Removing Obstacles to Increased Electric Generation... When one digs further and examines the citation to the page of the comments where Morgan Stanley claims that the ISO found their proposal to be a viable option, one finds only the same assertion, this time with out any footnote. Morgan Stanley has misrepresented the ISO's position. What does exist is the ISO's desire to make the maximum transmission capacity available to the all Market Participants. However, the

Morgan Stanley arbitrary interim approach is clearly not the right method for either the Market Participants or the ISO.

III. CONCLUSION

For the reasons discussed above, the Commission should deny Morgan Stanley's complaint. The ISO is not the correct party to resolve the scheduling timelines associated with Existing Contracts, it is not a party to such Existing Contracts and must accept the operating instructions provided by the Participating TOs. In the alternative, the Commission should adopt one of the ISO's proposals articulated in Docket No. EL01-47.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned dockets.

Dated at Washington, DC, on this 5th day of July, 2001.

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