

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

California Independent System) Docket Nos. ER02-1656-021
Operator Corporation)

**MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO
MOTIONS TO INTERVENE, MOTIONS TO REJECT, COMMENTS, AND
PROTESTS**

I. INTRODUCTION AND SUMMARY

On December 8, 2004, the California Independent System Operator Corporation (“ISO”) filed its Proposal For Honoring Existing Transmission Contracts Under The Amended Comprehensive Market Design Proposal (“ETC Proposal” or “December 8 Filing”). The ISO’s proposal for honoring existing transmission contracts (“ETCs”) is comprised of three main components: (1) scheduling the use of ETC rights into the ISO’s markets; (2) settlement and allocation of ISO charges associated with ETC schedules; and (3) validating that ETC schedules submitted to the ISO are consistent with the ETC rights holder’s contractual rights. With respect to component (1), the ISO proposed to honor fully all scheduling and firm transmission service rights contained in ETCs. To honor such ETC rights, the ISO proposed, *inter alia*, to give Day-Ahead and Hour-Ahead scheduling priority to valid ETC schedules and schedule changes and to “set aside” unscheduled ETC capacity on the interties in the Day-Ahead. The ISO proposed not to “set-aside” unscheduled ETC capacity on the internal transmission network, including Paths 15 and 26, because such “set-aside” of capacity was not necessary to honor ETC transmission rights and would likely

impose significant costs on customers and bring undue complexity to the market design. On the internal transmission network, the ISO will accommodate valid post-Day-Ahead ETC schedule changes via re-dispatch, if necessary.

With respect to component (2), the ISO proposed a “perfect hedge” mechanism whereby ETC rights holders will be held financially harmless from all ISO congestion charges (*i.e.*, both Day-Ahead and Real-Time) associated with the implementation of Locational Marginal Pricing (“LMP”) and the ETC Proposal. With respect to component (3), the ISO offered to provide -- as an option -- an automated procedure for verifying that submitted schedules utilizing ETC rights are consistent with a set of parameters specified by the Responsible Participating Transmission Owner, *i.e.*, the seller under the contract. The automated procedure will relieve the seller of the ETC of the need to validate ETC schedules on a day-to-day basis, while still holding the seller responsible for providing validation parameters to the ISO that correctly reflect contractual rights.

The ISO requested that the Commission approve the ETC Proposal on a conceptual basis. The ISO noted in the December 8 Filing that the ETC Proposal was not complete in every respect because certain details regarding the treatment of ETCs with respect to losses and non-congestion related settlement charges would be addressed in a subsequent stakeholder process and when the ISO files its MRTU Tariff. The ISO stated that issues pertaining to losses and charges other than congestion would be addressed in a subsequent stakeholder process, and that the outcome of those issues was not being pre-judged by the ETC Proposal. The ISO also stated that details of the ETC

Proposal would be included in the MRTU Tariff filing which would also be the subject of a stakeholder process. The ISO stressed that the purpose for filing the ETC Proposal at this time was to obtain sufficient conceptual approval of the treatment of ETCs under the ISO's Market Redesign and Technology Upgrade project ("MRTU") so that the ISO could (1) proceed with development of the software and systems needed to accommodate ETCs, and (2) maintain the MRTU project development and implementation schedule.

More than 20 parties submitted motions to intervene, motions to reject, comments, and protests concerning the Proposal.¹ The ISO does not oppose the interventions of parties that have sought leave to intervene in the proceeding. The CPUC, EOB, PG&E and SCE support the entirety of the ISO's proposal for honoring ETCs and believe that the proposal appropriately balances the concerns of all stakeholders.² Moreover, numerous parties state that they support some of the specific elements of the ETC Proposal. However, some

¹ Motions to intervene, motions to reject, comments, and/or protests were submitted by the following entities: Bonneville Power Administration ("BPA"); California Department of Water Resources State Water Project ("CDWR"); California Electricity Oversight Board ("EOB"); California Municipal Utilities Association ("CMUA"); Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California ("Southern Cities"); City and County of San Francisco ("CCSF"); City of Los Angeles Department of Water and Power ("LADWP"); City of Redding, California, Redding Electric Utility ("Redding"); City of Santa Clara, California, Silicon Valley Power ("SVP"); The Metropolitan Water District of Southern California ("MWD"); Modesto Irrigation District ("MID"); Pacific Gas and Electric Company ("PG&E"); Sacramento Municipal Utility District ("SMUD"); M-S-R Public Power Agency ("MSR"); San Diego Gas & Electric Company ("SDG&E"); Southern California Edison Company ("SCE"); Powerex Corp. ("Powerex"); Arizona Electric Power Cooperative, Inc. ("AEPSCO"); Transmission Agency of Northern California ("TANC"); Midway Sunset Cogeneration Company ("MSCC"); Morgan Stanley Capital Group, Inc. ("Morgan Stanley") and the Public Utilities Commission of the State of California ("CPUC"). On December 29, 2004, the Commission granted parties until January 11, 2005 to file comments on the ETC Proposal. Although one party filed comments after that date (and numerous parties filed comments before that date), the ISO is hereby filing its comments within 15 days of January 11.

² Although the CPUC opposes the concept of "setting-aside" unscheduled ETC capacity on the interties, the CPUC nevertheless finds the ETC Proposal to be acceptable because, *inter alia*, it is the product of "give-and-take" during the stakeholder process, and this "compromise is acceptable" given the "many advantages of the rest of the ETC Proposal."

parties raise certain concerns and criticisms with regard to the ETC Proposal. Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213, the ISO hereby requests leave to file an answer, and files its answer, to the motions to reject, comments, and protests submitted in this proceeding.³

Of the 22 parties that intervened in this proceeding, five parties object to the ISO's proposal to "set-aside" unscheduled ETC capacity on the interties. Only two parties allege that the ISO's proposal not to "set-aside" unscheduled ETC capacity on the internal transmission network results in a failure to honor ETC scheduling rights. As discussed in greater detail in the Transmittal Letter to the December 8 Filing, it is imperative that the ISO not be required to "set-aside" unscheduled ETC capacity on the internal network, including Paths 15 and 26, in the Day-Ahead. Such a requirement would (1) add significant undue complexity to the market design (basically forcing the ISO to "set-aside" excess capacity throughout the entirety of the transmission system not just on Paths 15 and 26), (2) increase the systems/software related costs associated with MRTU, and (3) produce dramatic market inefficiencies. Further, it is unnecessary to "set aside" unscheduled ETC capacity on the internal network in order to accommodate ETC scheduling and firm service rights. Indeed, the ISO's proposal is consistent with how the PTOs accommodated ETCs prior to the formation of the ISO and with

³ To the extent this answer is deemed an answer to protests, the CAISO requests waiver of Rule 213 (18 C.F.R § 385.213) to permit it to make this answer. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case. See, e.g., *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163 (2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Company*, 93 FERC ¶ 61,098, at 61,259 (2000).

the measures that the Commission approved for the Midwest Independent System Operator (“MISO”) for purposes of honoring grandfathered agreements. The two parties objecting to the ISO’s method of accommodating ETC transmission rights on the internal network did not point to any specific ETC provision that the proposal violates and did not provide any specific information supporting their general, unsubstantiated claims that the ISO’s proposal would fail to honor the scheduling and firm service rights under their ETCs. To the contrary, the ISO proposes to fully honor ETC scheduling and transmission rights and does not propose in any way to modify or abrogate ETCs.

The ISO acknowledges that the ETC Proposal does not resolve every issue or detail associated with the treatment of ETCs under MRTU. However, it resolves two important issues -- the treatment of ETCs on the interties and on the internal network -- that must be resolved in order for the ISO to move forward with software and systems development, thereby maintaining the MRTU project schedule. Although the ISO’s proposal may not eliminate all market inefficiencies on the ISO-Controlled Grid (as a result of “setting-aside” unscheduled ETC capacity on the interties and adopting a “perfect hedge” against congestion costs that would otherwise be incurred by ETC schedules), the ISO has consciously “erred” on the side of fully honoring ETCs and believes that these proposals are appropriate to ensure that the ISO can fully honor ETC rights. The ISO submits that the ETC Proposal reduces market inefficiencies to the maximum extent possible given the ISO’s overarching goal of fully honoring ETC rights. Other issues (*e.g.*, the treatment of losses and costs other than

congestion, as well as detailed Tariff language not addressed by the conceptual filing) will be addressed in a future stakeholder process, and the instant ETC Proposal does not prejudge the outcome of those issues in any way. Thus, the rights of ETC holders are fully protected by the ISO's filing.

Accordingly, for the reasons set forth, below, the Commission should: (1) approve the ETC Proposal in its entirety, and (2) approve the process specified in the December 8 Filing for addressing specified unresolved ETC issues. This will enable the ISO to proceed with MRTU systems and software development and maintain the current MRTU implementation schedule.

II. **ANSWER⁴**

A. **The ISO's Proposal To "Set-Aside" Unscheduled ETC Capacity On The Interties Is A Reasonable Approach To Honoring ETC Rights**

BPA, SDG&E, Morgan Stanley and the CPUC submitted comments opposing the ISO's proposal to "set-aside" unscheduled ETC capacity on the interties.⁵ SDG&E, BPA and Morgan Stanley argue that "setting-aside" capacity on the interties will promote phantom congestion. SDG&E at 2; BPA at 3; Morgan Stanley at 3. BPA and Morgan Stanley also claim that the proposal unfairly discriminates against importers by limiting access to transmission in a manner that does not apply within the ISO Control Area. BPA at 5-6; Morgan Stanley at 6-8; CPUC at 2.

⁴ In this Answer, citations to the transmittal letter for the December 8 Filing will be to pages of "Transmittal Letter," citations to the amended proposal contained in Attachment A to the December 8 Filing will be to paragraphs in "Attachment A," and citations to the other lettered attachments to the December 8 Filing will be to those particular attachments.

⁵ In its comments, Powerex indicated its support for BPA's protest on the issue of "setting-aside" unscheduled ETC capacity on the interties. Also, as indicated above, although the CPUC opposes the concept of "setting-aside" unscheduled ETC capacity on the interties, it supports Commission approval of the ETC Proposal as a compromise package.

1. Although The ISO's Proposal For Honoring ETCs On The Interties Will Result In Some Market Inefficiencies, It Assures That The ISO Can Honor ETC Rights

The ISO recognizes that its proposal to “set-aside” unscheduled ETC capacity on the interties will result in some inefficiencies in the marketplace. However, the ISO is fully committed to honoring ETC rights. The ISO concluded that “setting-aside” unscheduled ETC capacity was the best way to honor ETC rights on the interties. As the ISO indicated in the December 8 Filing, absent a “set-aside” of unscheduled ETC capacity on the interties, the ISO could not guarantee that it would be able to honor valid post-Day-Ahead ETC schedule changes 100 percent of the time due to seams issues and the fact that the ISO does not control generation on the other side of the intertie, thereby limiting the ISO's re-dispatch ability at the interties. Stated differently, the ISO's ability to re-dispatch resources is more limited on the interties than on the internal transmission network. Moreover, because interties are modeled as radial to the system, the impact of “setting-aside” unscheduled ETC capacity on the interties will be limited. Thus, although the ISO's proposal does not promote maximum efficiency, it is appropriate in order to honor ETC rights on the interties.

The ISO also believes the impact upon the market of “setting-aside” unscheduled ETC capacity on the interties will not be significant. As part of the stakeholder process, the ISO analyzed the historical congestion data in 2003 for the purpose of estimating the MW impact of setting aside unscheduled ETC capacity at the interties. The ISO summarized the results of this analysis in its

filing and posted on its website the detailed presentation given to stakeholders in a public meeting.

As it turned out, the only relevant data was from the California-Oregon Inter-tie (“COI”) and the Palo Verde Inter-tie (“PV”) because only these two interties experienced significant day-ahead congestion in 2003. For COI, approximately 2300 hours (out of 8760) of the year were congested in the Day-Ahead market. For these hours, the ISO analyzed the amount of New Firm Use (*i.e.*, non-ETC) schedules that could have been accepted Day-Ahead if the ISO had “set-aside” only the amount of ETC capacity that ETC holders actually used in each hour (combining both Day-Ahead ETC schedules and post-Day-Ahead schedule changes), versus the amount accepted when the ISO “set-aside” the full amount of capacity specified by the ETC rights. This difference, which amounted to an average of 98 MWs for the 2300 hours of congestion at COI, was insufficient to fully eliminate Day-Ahead congestion on COI. In other words, even if the ISO could have “set-aside” only the amount of capacity for ETCs that they actually used, thereby totally eliminating the phenomenon referred to as “phantom congestion,” it would not, on average, have eliminated Day-Ahead congestion on the associated intertie.

PV had only 725 congested hours in 2003, or less than a third of the congestion experienced at COI. The ISO also performed the comparison described above to PV, and determined that the difference amounted to an average of 76 MWs for the 725 hours of congestion at PV. Thus, on average,

Day-Ahead congestion at PV would not have been eliminated by the ISO “setting-aside” only the amount of capacity actually used by the ETCs.

To place these numbers in perspective, it is important to compare them to the actual rated capacities of these two interties, *i.e.*, 4800 MW for COI and 2823 MW for Palo Verde. Thus, for 2003, the additional New Firm Use schedules that would have been accepted Day-Ahead if the unused ETC capacity was available was only approximately two-to-three percent of the capacity of each intertie. Therefore, the ISO therefore believes that “setting-aside” ETC capacity at the interties provides the best balance between ensuring that ETCs are fully honored and reducing the potential for significant market inefficiencies to continue.

2. It Is Not Unduly Discriminatory For The ISO To Set Aside Unscheduled ETC Capacity On The Interties But Not On The Internal Transmission Network

Contrary to the claims of BPA and Morgan Stanley, the ISO is not unduly discriminating against importers because the interties are materially different than the internal network transmission facilities for purposes of accommodating ETCs.

First, as indicated above, the ISO only controls dispatchable generation on one side of the intertie. Therefore, the ISO cannot rely on re-dispatch to accommodate ETC schedule changes to the same degree that it can on the internal network and, in some instances, the ISO could have to curtail either the ETC schedule change or a non-ETC intertie schedule. Thus, absent a “set-aside” of capacity for ETCs, there is some risk that the ISO would not be able to honor a valid ETC schedule change under those circumstances. The ISO does not face this problem on the internal transmission network because it controls all

Participating Generator Agreement (“PGA”) resources within the network and can re-dispatch such resources in Real-Time when necessary to accommodate valid ETC schedule changes.

Second, the interties will be modeled radially in the Full Network Model, whereas, the internal transmission grid will be modeled as a fully integrated meshed network. Under MRTU, an intertie is essentially modeled, for market purposes, as if it were a straw whereby power injected at the external end flows through the straw to the point of withdrawal inside the ISO grid. In other words, with this radial representation of an intertie there is only one available source for the energy and one available path on which energy can flow to the point of withdrawal. This limits the ability of the ISO to honor valid ETC schedule changes. The bottom line is that the ISO’s options for relieving congestion on the interties are more limited than on the internal network. On the internal transmission network, power flows in many directions, and a multitude of resources at various locations can be utilized to relieve any particular constraint. For this reason, the ISO can more easily accommodate valid post-Day-Ahead schedule changes on the internal network.

Third, “setting-aside” unscheduled ETC capacity on the internal transmission network is significantly more complex and more difficult than “setting-aside” unscheduled ETC capacity on the interties. This difference is clearly set forth in the Transmittal Letter to the December 8 Filing and need not be repeated here. Transmittal Letter at 17-22.

Fourth , BPA’s suggestion that the interties are similar to Paths 15 and 26 because “they are discrete paths for which contract rights, schedules, and flows are relatively easily known” is irrelevant because the purported similarity is a function of today’s zonal network model that will not be in place when MRTU is implemented. Withholding transmission capacity for unscheduled ETC rights in today’s forward market’s is a simpler process because of the radial configuration of the zonal network model and the small number of transmission constraints that are enforced in forward congestion management. December 8 Filing, Transmittal Letter at 19. Only the congestion zone of origin and the congestion zone of destination are needed for each ETC to determine the interzonal interfaces where ETC capacity must be “set-aside.” However, the current distinction between inter-zonal and intra-zonal interfaces will be eliminated under MRTU. Under MRTU, schedules that utilize Paths 15 and 26 will be represented as injections at specific network nodes on one side of these paths and withdrawals on the other side, with resulting electrical flows throughout the entire network. In other words, when the Full Network Model is used for congestion management, there will not be -- nor can there reasonably be -- “discrete” schedules, rights and flows” on these internal transmission lines. See discussion at pages 17-20 of Transmittal Letter.

B. SMUD And CCSF Have Not Identified Any Legitimate Reasons To Reject The ISO’s Proposal Not To “Set-Aside” Unscheduled ETC Capacity On The Internal Network

Only SMUD and CCSF claim that the ISO’s proposal not to “set-aside” unscheduled ETC capacity on the internal transmission network fails to honor

ETC rights. SMUD alleges that the ISO has not guaranteed that transmission capacity will be available in the post-Day-Ahead timeframe to accommodate post-Day-Ahead schedule changes and, therefore, the ISO is failing to honor ETCs. SMUD at 8. CCSF argues erroneously that the ISO's proposal does not honor the scheduling flexibility in its ETC. CCSF at 3. CCSF also argues that the proposal does not honor other elements of its ETC, most of which are not transmission-related provisions.

There is no basis whatsoever for SMUD's and CCSF's claims. As an initial matter, SMUD misrepresents the ISO's proposal (and the ISO's existing practice) by claiming that that the ISO is "eliminating the practice of reserving capacity to accommodate the ETC holders' scheduling rights for the ISO's internal network." SMUD at 6. As the ISO indicated in its December 8 Filing, the ISO does not currently "set-aside" unscheduled ETC capacity on its internal network. December 8 Filing, Transmittal Letter at 6, 28, n. 30, 37. The ISO only "sets-aside" capacity on the interties and on Paths 15 and 26. The only change to existing practice that the ISO is proposing herein is to no longer "set-aside" unscheduled ETC capacity on Paths 15 and Paths 26. Under MRTU, these transmission lines will be modeled under the Full Network Model as part of the internal network. Thus, contrary to SMUDs erroneous characterizations, the ISO's proposal to not "set-aside" capacity on the internal network reflects continuation of an existing practice.

The means by which the ISO proposes to honor ETC rights on Paths 15 and 26 under MRTU, as well as the remainder of the internal transmission

network, is the **same** means that the ISO currently employs under the zonal model to honor ETC rights on today's intra-zonal interfaces. In that regard, in order to provide transmission for ETC rights holders on intra-zonal interfaces, the ISO does not currently "set-aside" unscheduled ETC capacity on intra-zonal interfaces in the Day-Ahead. Rather, the ISO simply dispatches resources to balance the grid in Real-Time in a manner that allows intra-zonal ETC schedules to be honored. Under MRTU, the ISO proposes to continue this practice in Real-Time and, in addition, to provide scheduling priority to ETCs in the Day-Ahead market and the Hour Ahead Scheduling Process.⁶ Contrary to SMUD's argument, the ISO does not need to continue to "set-aside" capacity on Paths 15 and 26 (or to now "set-aside" capacity on the other internal paths) in order to honor ETCs. The ISO no longer needs to "set-aside" capacity on Paths 15 and 26 because – from a pricing and congestion management standpoint – there no longer is a distinction between Paths 15 and 26 and the rest of the transmission network. The need to "set-aside" capacity on these paths today is driven by the distinct features of a Zonal pricing paradigm that establishes an artificial – and now proven to be inappropriate – distinction between "Inter-Zonal" and "Intra-Zonal" transmission paths. The ISO proposes to eliminate that distinction by implementing LMP. This will allow the ISO to optimally manage congestion on the system while continuing to accommodate pre-existing rights through the very same re-dispatch that enables LMP.

⁶ CCSF argues that the ISO should provide ETC rights holders with a scheduling priority in the Hour-Ahead market as well as the Day-Ahead market. As the ISO indicated in its December 8 Filing, the ISO is providing ETC rights holders with a scheduling priority in both the Day-Ahead and Hour-Ahead markets. December 8 Filing, Transmittal Letter at 28. Specifically, Hour-Ahead ETC schedule changes will be given a priority over all other Hour-Ahead schedule changes. *Id.*

The ISO's proposed approach to honoring ETC rights on the internal network also is consistent with the manner in which the PTOs honored ETC rights prior to formation of the ISO and reflects all of the elements that the Commission found necessary in order for the MISO to honor grandfathered agreements.⁷ No party filing comments on the ETC Proposal disagrees with these facts. Further, SMUD and CCSF cannot point to a single provision in any ETC to which they are a party that is abrogated by the ISO's proposal not to "set-aside" unscheduled ETC capacity on the internal network. Under these circumstances, it cannot reasonably be argued that the ISO's treatment of ETCs on the internal network abrogates ETC rights.

SMUD does not provide any specific evidence or reasons as to how the ETC Proposal fails to honor its ETCs. Rather, SMUD simply makes a rash unsubstantiated claim that there is no guarantee that it will receive the service to which it is entitled. As the Commission has recognized, firm service simply means that a customer (1) will be able to transmit power between its specified source and sink without service interruption (**absent force majeure or curtailment**), (2) is entitled to the scheduling and curtailment priorities and terms that reflect the firm nature of the service, and (3) is not subjected to any additional costs outside of those for which it has contracted. *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, 109 FERC ¶ 61,138 at P 143 (2002); see also *City of*

⁷ See *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236 (2004). Indeed, for the reasons set forth in the December 8 Filing, the ISO's proposed treatment of ETCs is even more protective of ETCs than the measures the Commission adopted for MISO's grandfathered agreements. See December 8 Filing, Transmittal Letter at 44-45.

Freeport, New York v. Consolidated Edison Company of New York, Inc., 89 FERC ¶ 63,006 at 65,020 (1999), *aff'd*, 91 FERC ¶ 61,003 at 61,103 (2000), *aff'd on reh'g*, 101 FERC ¶ 61,225 (“*Freeport*”); *El Paso Electric Company*, 84 FERC ¶ 63,008 at 65,072-73(1998), *aff'd*, 87 FERC ¶ 61,202 at 61,767-78(1999).

The ETC Proposal satisfies all of the requirements of firm service. The ISO is treating valid ETC schedules and valid schedule changes as firm. ETCs will have a scheduling priority in the Day-Ahead market and the Hour-Ahead market and, where necessary, the ISO will re-dispatch resources to accommodate post-day-Ahead ETC schedule changes. ETC rights holders will not be responsible for such re-dispatch costs.⁸ Further, ETCs will have the same curtailment priority that they have today. As a general rule, this means that ETCs

⁸ On numerous occasions, the Commission has recognized the appropriateness and the viability of relying on re-dispatch to provide firm service. See, e.g., *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236 at PP 142-143; *Midwest Independent Transmission System Operator, Inc.*, 99 FERC ¶ 61,198 at 61,822 and n. 29 (2002); *Midwest Independent Transmission System Operator, Inc.*, 98 FERC ¶ 61,075 at 61,218-19 (2002); *Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶61, 326 at 62,511-13(2001); *Mid-Continent Area Power Pool*, 91 FERC ¶ 61,065 at 61,229-30 (2000); *Grid South Transco, LLC et al.*, 96 FERC ¶ 61,067 at 61,295-96 (2001). Indeed, in Order No. 888 and the *pro forma* OATT, the Commission recognized the appropriateness of using re-dispatch to maintain firm service and provide new firm service. *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, Order No. 888, FERC Stats. & Regs. [Regulations Preambles 1991-1996], ¶ 31,036 at 31,938, 31,957-58 (1996). Likewise, the Commission has recognized the need for independent transmission providers to utilize re-dispatch to maintain system reliability and avoid curtailments. *Regional Transmission Organizations*, Order No. 2000, FERC Stats. & Regs. [Regulations Preambles 1996-2000], ¶ 31,089 at 31, 104, 31,126-27, *order on reh'g*, Order No. 2000-A, FERC Stats. & Regs. [Regulations Preambles 1996-2000], ¶ 31,092 at 31,373 (2000). That is exactly what the ISO is proposing here, if necessary, to honor ETC firm service rights. Because other transmission providers rely on re-dispatch to provide firm transmission service, there is no legitimate reason why the ISO should not be permitted to do the same. Indeed, the ISO today relies on re-dispatch to maintain firm service and provide new firm service. The ISO also submits that, because most of the ETCs are point-to-point contracts, in certain instances, the ISO could actually be according ETC rights holders more benefits than they are entitled to under their ETCs by agreeing to re-dispatch resources to accommodate ETC schedule changes. *Freeport*, 91 FERC at 61,013 (as a point-to-point transmission customer Freeport is not entitled to re-dispatch as an alternative to curtailment); *Utah Associated Municipal Power Systems v. Pacificorp*, 87 FERC ¶ 61,044 at 61,190(1999) (absent compelling evidence, the Commission will not infer a re-dispatch obligation into contracts pre-dating Order No. 888).

are the last “service” to be curtailed.⁹ Thus, the ISO is according ETCs all of the firm service rights and priorities which they have today and to which they are entitled under their contracts.¹⁰

CCSF alleges that the ETC Proposal diminishes ETC rights because it does not address “the breadth and complexity” of all of the provisions of ETCs. CCSF misunderstands the purpose of the ETC Proposal. The ETC Proposal is only intended to address the transmission component of ETCs and not other non-transmission elements of ETCs. Contrary to CCSF’s claims, the ISO is proposing to honor the scheduling rights contained in ETCs. CCSF does not provide any specifics as to how the ISO’s proposal not to “set-aside” unscheduled ETC capacity on the internal network abrogates or diminishes the firm service rights CCSF has in its ETCs.

C. The “Perfect Hedge” Mechanism Assures That The ISO Can Honor ETC Rights

SDG&E argues that the perfect hedge will not promote efficient ETC scheduling and will likely continue phantom congestion. SDG&E at 2. The ISO concedes that the “perfect hedge” will not ensure perfectly efficient scheduling practices by ETC holders and will result in some market inefficiencies. However,

⁹ ETCs on specific transmission paths may be subject to different curtailment priorities based on PTO Operating Instructions for the specific path.

¹⁰ CDWR states that it has the highest priority firm transmission service -- a higher priority than all other ETCs. CDWR states that this means that, under its ETC, before PG&E can curtail CDWR’s firm transmission for reasons other than a physical de-rate, PG&E must take steps to preserve CDWR’s highest priority rights. CDWR at 4-5. CDWR states that the ETC Proposal does not address this matter, but merely gives ETC schedules a general Day-Ahead priority (CDWR ignores the fact that the ISO also is according ETCs a priority in the Hour-Ahead). As the ISO indicated in the December 8 Filing, the ISO proposes to honor all ETC rights. Thus, to the extent CDWR has a “super” priority, the ISO will honor such priority. The proposed “perfect hedge” mechanism and the ISO’s proposal to utilize re-dispatch where necessary to maintain firm service rights will accommodate CDWR’s contractual rights.

this feature of its ETC proposal will enable the ISO to ensure that ETCs are fully honored under the MRTU market design. Thus, the inefficiencies exist because the ISO desires to honor contracts. Further, although implementation of a “perfect hedge” mechanism will not eliminate market inefficiencies, it is better than requiring the ISO to “set-aside” unscheduled ETC capacity on the internal transmission network. Not only would that add undue and burdensome complexity to the modeling process and the market design, it would produce market inefficiencies that are significantly greater than those created by the “perfect hedge.” Transmission efficiency will be greatly improved as a result of the ISO’s proposal and, as such, the Commission should approve the proposal. As the Commission recognized in its order on MISO’s grandfathered agreements, although the mechanism adopted by the Commission would result in some inefficiencies (*i.e.*, additional costs being imposed on non-GFA customers), it would result in a more reliable and efficient market overall.

Midwest Independent Transmission System Operator, Inc. 108 FERC ¶ 61,236 at P 89. The same reasoning applies here.

D. The ISO Has Fulfilled Its Obligations Under The October 28, 2003 Order

TANC and SMUD claim that the December 8 Filing does not adequately respond to the Commission’s October 28, 2003 order¹¹ instructing the ISO to prepare an analysis of the impacts of the ETC Proposal and to share the results with stakeholders. TANC at 3-4; SMUD at 4. TANC states that the impact estimates prepared by the ISO during the stakeholder process were referenced

¹¹ *California Independent System Operator Corporation*, 100 FERC ¶ 61,060 at 61,237-38 (2003) (“October 28 Order”).

only briefly in the filing. TANC acknowledges that, during the stakeholder process, the ISO indicated that estimating the market impacts of the ETC alternatives was a difficult (and potentially subjective) process and represented that it did not perform detailed studies of the cost impacts to the market. TANC states that the ISO did not provide copies of its cost impact analysis to stakeholders, but recognizes that the ISO discussed the cost impact studies in its documents submitted to the ISO Governing Board, which documents are publicly available.¹²

In the October 28 Order, the Commission recognized that the ISO's then-filed ETC proposal might alter the rights of ETC holders if deviations to schedules could not be accommodated. The Commission concluded that more detailed evidence was required regarding the magnitude of the problem sought to be addressed and the likely consequences of any proposal (including any potential variation in costs ETC rights holders might face). October 28 Order at P 201. Accordingly, the Commission "require[d] that the CAISO conduct further analysis of the proposal that will demonstrate the likelihood of ETC holders experiencing a diminution of contractual rights if the revised scheduling process is adopted."

¹² MID suggests that the ISO should consider other possible -- and better -- options for accommodating ETCs such as converting ETCs from demand-based billing to volumetric billing. MID at 4-5. It is axiomatic that, under Section 205 of the Federal Power Act, the ISO is not required to file the best possible alternative; the ISO is only required to file a proposal that is just and reasonable. See *New England Power Company*, 52 FERC ¶ 61,090 at 61,336 (1990), *reh'g denied*, 54 FERC ¶ 61,055, *aff'd Town of Norwood v. FERC*, 962 F.2d 20 (D.C.Cir. 1992); *citng City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 917 (1984) (utility need establish that its proposed rate design is reasonable, not that it is superior to alternatives); *OXY USA, Inc. v. FERC*, 64 F.3d 679, 692 (D.C.Cir. 1995) ("[T]he Commission may approve the methodology proposed in the settlement agreement if it is 'just and reasonable'; it need not be the only reasonable methodology or even the most accurate."). The ISO has filed a proposal that is just and reasonable. Accordingly, the Commission cannot simply substitute a proposal that it deems to be better. In any event, MID appears to be concerned with the allocation of costs incurred to honor ETCs and does not offer any evidence that the ISO's proposal violates ETC rights.

October 28 Order at P 202. Thus, the purpose of the “further analysis” the ISO was supposed to undertake was to show that ETC rights will not be diminished by its proposal. The ISO submits that it has fulfilled its obligations under the October 28 Order, and no additional analysis or stakeholder process is necessary to demonstrate that ETC rights will not be diminished.

The ISO held an extensive stakeholder process subsequent to the October 28 Order in which it evaluated the pros and cons of the conceptual proposal as well as viable alternatives. Importantly, as a result of this stakeholder process, the ISO has made two significant modifications to the ETC proposal that the Commission considered in its October 28 Order. These modifications should fully assuage any concerns the Commission may have about honoring ETC rights without imposing any additional, impermissible costs on ETC rights holders. First, the ISO is now proposing to “set-aside” unscheduled ETC capacity on the interties in the Day-Ahead. On the other hand, in the October 28 Order, the Commission was considering a proposal in which the ISO was proposing not to “set-aside” unscheduled ETC capacity on the interties. This issue was a major “bone of contention” with ETC rights holders who claimed that failure to “set-aside” capacity on the interties could jeopardize their ETC rights. In response to these claims and the statements in the October 28 Order, the ISO went back and thoroughly evaluated the situation. Given the radial nature of interties, the seams issues that exist there and the ISO’s limited re-dispatch ability at the interties (given that the ISO does not control dispatchable generation on the other side of the intertie), the ISO

concluded that it could not guarantee that it could honor post-Day-Ahead ETC schedule changes on the interties 100 percent of the time. Accordingly, the ISO modified its proposal. No ETC rights holder contends that that the ISO's proposed treatment of ETCs on the interties fails to honor ETC rights. Thus, the ISO has satisfied the instructions in the October 28 Order with respect to this issue.

The second major modification the ISO made to its prior proposal was the "perfect hedge" which will fully shield ETC rights holders from any Day-Ahead or Real-Time congestion charges they would otherwise incur as a result of implementing the ISO's ETC Proposal. This fully addresses the other concern the Commission expressed in the October 28 Order, *i.e.*, the potential variation in costs ETC rights holders might incur as a result of implementation of the ISO's proposal. The answer is that they will not incur any additional costs because of the "perfect hedge." Thus, the ISO has satisfied the instructions in the October 28 Order with respect to the "cost exposure" issue.¹³

With respect to the issue of honoring ETC rights on the internal transmission network (including Paths 15 and 26), the ISO (1) reviewed ETC contracts, the submissions of the PTOs and ETC rights holders with the Commission regarding the terms of ETCs, and PTO Operating Instructions for ETCs, (2) identified and reviewed the practices of the PTOs regarding the treatment of ETCs prior to formation of the ISO, (3) reviewed the MISO order on

¹³ The "perfect hedge" proposal is supported by ETC rights holders. The only concern some ETC rights holders raise is that the "perfect hedge" proposal does not address costs other than congestion. As the ISO has indicated previously, the instant filing does not address (or pre-judge) the treatment of such costs which will be addressed in a subsequent stakeholder process.

grandfathered agreements (“GFAs”) and indicated how the ISO satisfied all of requirements the Commission imposed on MISO in order to honor GFAs,¹⁴ (4) evaluated its existing practice of not “setting-aside” unscheduled ETC capacity on the internal transmission network, and (5) evaluated its ability to rely on re-dispatch to accommodate post-Day-Ahead schedule changes, if necessary. Based on this thorough and reasoned analysis, the ISO concluded that “setting-aside” unscheduled ETC capacity on the internal network is not necessary to honor ETC rights, nor is it legally required under any ETC. If necessary, the ISO can accommodate post-Day-Ahead ETC schedule changes via re-dispatch just like other transmission providers, including MISO. Only two parties have objected to this approach, and there is no merit to their unsubstantiated objections.

Thus, the ISO has satisfied the instructions in the October 28 Order that it “conduct further analysis of the proposal that will demonstrate the likelihood of ETC holders experiencing a diminution of contractual rights if the revised

¹⁴ SVP requests that the ISO clarify its statement at page 45 of the Transmittal Letter to the December 8 Filing that the ISO satisfies “item (4) [of the carve-out requirements that the Commission approved for MISO] because the ETC rights holder and the PTO can agree to settle Real-Time imbalances through their ETC or through the Imbalance Energy market.” The ISO clarifies that ETC holders will be allowed to submit balanced Real-Time schedule changes to the ISO up to the deadlines specified by their contracts, or no later than 20 minutes before the start of the operating hour as is the requirement today. For these scheduled quantities, there will be no ISO imbalance charges for energy because the injection and withdrawal quantities are balanced; nor will there be any congestion charges because the “perfect hedge” will apply. Of course, any subsequent deviations from these Real-Time schedule changes will appropriately be subject to ISO imbalance energy charges because they occur after the contractual deadline for submitting ETC schedule changes and, therefore, are not considered valid ETC schedule changes. Further, they are not covered by the provisions of the ISO’s ETC proposal which is intended to apply only to the transmission service aspects of contracts (that in some cases cover additional services). As a result, if the ETC rights holder’s contract is supposed to cover charges for Real-Time imbalance energy, the parties to the ETC will need to determine an appropriate way for the seller of the contract to compensate the ETC holder for such charges. The ISO notes that MISO is essentially implementing the same approach in order to comply with the Commission’s directives regarding the “carve-out” of GFAs with *Mobile-Sierra* clauses. See MISO’s October 18, 2004 compliance filing in Docket Nos. ER04-691 and EL04-104.

scheduling process is adopted.” Indeed, as a result of this “further analysis,” the ISO modified its proposal to ensure that ETC rights holders do not suffer a diminution of service or additional costs. These modifications, and the ISO’s analysis regarding the impact of the ETC Proposal on ETC rights holders, was discussed fully with stakeholders during the extensive stakeholder process conducted by the ISO.

A few stakeholders complain that the ISO’s studies regarding the cost impact of “setting-aside” unscheduled ETC capacity on the interties and on the internal network are not detailed enough and were not fully vetted with stakeholders. The ISO acknowledges that it did not submit detailed studies. However, the studies the ISO conducted were only intended to show a general order of magnitude of the relative costs of “setting-aside” capacity on the interties versus the internal transmission network. It can be debated *ad infinitum* what the actual cost impact of “setting-aside” ETC capacity is, but that would be a “fruitless” debate.¹⁵ Moreover, the ISO’s proposal does not hinge on the cost impact of “setting-aside” unscheduled ETC capacity. Rather, the ISO’s proposal hinges on honoring contracts and avoiding the extreme complexity of having to model ETC capacity “set-asides” in the Full Network Model. As the ISO indicated

¹⁵ Estimating the market impacts of ETC capacity “set-asides” is an extremely difficult (and potentially subjective) process. This issue has been debated *ad nauseum* since start-up and market participants are polarized on the issue of the cost impact of ETC capacity “set-asides.” It is particularly difficult to estimate a market impact for the year 2007 using historical data. In that regard, numerous factors will have changed, thereby limiting the predictive value of historical data. For starter, the Path 15 upgrade was placed in service in the fourth quarter of 2004, and it is expected that the COTP line will be taken out of the ISO Control Area by the end of 2005. Further, it is difficult to model load growth and anticipate grid additions that would be in place in 2007. The most any study can do is show a general order of magnitude of the cost of “setting-aside” unscheduled ETC capacity, and the ISO has done that. Because the ISO is not proposing to modify or abrogate ETCs, it is not necessary to develop more detailed cost data to justify such actions.

in the December 8 Filing and herein, “setting-aside” unscheduled capacity on the interties but not on the internal network is necessary to achieve both of these objectives. Any concerns ETC rights holders might have regarding a diminution of contract rights have been adequately addressed by the ISO’s new “perfect hedge” proposal and the “setting-aside” of unscheduled ETC capacity on the interties. Further, other issues such as losses and costs other than congestion will be addressed later and are not being pre-judged by this filing. Because ETC rights holders are not bearing any congestion costs, there is no cost impact on them from the ETC Proposal. Thus, the Commission’s concerns expressed in the October 28 Order about ETC rights holders bearing additional costs as a result of the ISO’s proposal have been adequately addressed.¹⁶ Indeed, ETC rights holders do not object to the “perfect hedge” proposal or the proposal to “set-aside” unscheduled ETC capacity on the interties.

E. Validation issues

1. SDG&E’s Concerns

SDG&E argues the ISO should not be in the business of validating ETC schedules that are consistent with the terms of the ETC. SDG&E at 2. SDG&E states that such a service is not free and parties like SDG&E end up bearing the

¹⁶ MWD requests that the ISO identify the amount of ETC capacity that will be in existence in 2007 when the ISO implements MRTU. MWD states that it is difficult to determine the impact of the ISO’s proposal if it is unknown what the quantities of ETCs will be in 2007. MWD at 10-11. Appendix D to the ISO’s December 8 Filing does (1) set forth the ETCs that will be in effect in 2007, and (2) specify the MW quantity under the contract. That information is also contained in the contract templates previously filed with the Commission in Docket No. ER04-928. The ISO is unable to provide an exact number with any certainty because, as reflected by some of the comments, there are some disputes regarding the termination dates of some contracts. However, Appendix D provides an ample ballpark figure of the ETC quantities that must be accommodated at the start-up of MRTU. Further, it is not necessary for the ISO to determine the exact number of ETC MW in place in 2007 because the ISO is proposing to fully honor ETC rights and is not proposing to modify the terms of any ETC. In particular, the ISO, unlike the MISO is not proposing to treat ETCs with *Mobile-Sierra* clauses differently than ETCs without such clauses.

costs. *Id.* SDG&E also argues that the ISO is subjecting itself to liability if there is a dispute whether a particular schedule is valid. *Id.* SDG&E also argues the ISO should treat ETC schedules in the same manner as non-ETC schedules. The Scheduling Coordinator should be responsible for submitting ETC schedules and settling all costs with the respective ETC counterparties, thereby keeping the ISO out of the middle. *Id.* at 2-3.

The December 8 Filing outlines the validation process that would involve an automatic mechanism for the ISO to verify that ETC schedules conform to the data parameters submitted to the ISO by the Responsible PTOs. The Responsible PTOs would be responsible for ensuring that the schedules meet the terms of the contract. The ISO is only verifying that the schedule meets the parameters of a data file. This concept is quite similar to the process performed today, except that the validation process would be more automated and more formally prescribed by written procedures than it is today.

It is important to note that the ISO currently relies solely on the Responsible PTOs' instructions regarding the ETCs to which they are a party. This reliance on the Responsible PTOs has worked fairly well throughout the ISO's history, and any potential problems have been resolved easily or clarified quickly by the Responsible PTOs. The ISO does not anticipate an increase in disputes related to ETCs as a result of this more prescribed, automated process. Further, the ISO does not anticipate the addition of extra staff or incurrence of other additional costs as a result of the proposed automated process.

2. TANC's and SVP's Concerns

TANC expresses concern about the ISO's validation proposal inasmuch as it relies on Responsible PTO instructions for the ETC. TANC requests that the Commission instruct the ISO to include a resolution process that will facilitate agreement and resolution of disputes over operating instructions. TANC at 7. SVP argues that the ISO should not accept unilaterally filed operating instructions that have not been validated by all parties. SVP at 6. SVP states that acceptance by the ISO should require the agreement of all contract parties. SVP argues that, at a minimum, a resolution process needs to be developed. The ISO believes the contracting transmission provider should be responsible for the accuracy of the data parameters submitted to the ISO. This makes sense as a matter of convenience and experience because the Responsible PTOs already serve as the Scheduling Coordinator for most (but not all) ETCs. Under the existing ISO Tariff, the Responsible PTOs are the parties responsible for providing ETC Operating instructions to the ISO. See Section 2.4.4.4.1.1.

The ISO also believes that disputes between parties to the contract should be resolved outside the ISO. The ISO Tariff already specifies a means for resolving ETC disputes, and contracting parties have numerous means available to them to resolve disputes; so, the ISO sees no reason to create a new dispute resolution process just for ETC-related disputes, especially since the ISO is not party to these ETCs. In particular, the ETCs themselves have dispute resolution procedures, and the ISO's Tariff contemplates that those procedures should be used to resolve ETC-related disputes. For example, the existing Tariff

contemplates that disputes between the PTO and the ETC rights holder regarding information contained in Responsible PTO Operating Instructions should be handled via the mechanism(s) specified in the ETC. The ISO envisions that a similar requirement would be specified in the MRTU Tariff. The ISO notes that this issue was resolved as part of the longstanding “Unresolved Issues” proceeding wherein the Commission:

[r]eaffirm[ed] its conclusion that it is reasonable for the ISO to rely on the operating instructions of the Participating TO, and that Proponents' recommended revision to Section 2.4.4.4.1.1 is unworkable. As explained by SoCal Edison, there may not be a written set of instructions to turn over to the ISO and, even if there were, they may need to be adapted to function in the ISO market. Further, simply turning over the disputed contract and any written instructions to the ISO for implementation is not feasible. If the contract and any related written instructions are subject to ambiguity so that the parties disagree over their interpretation, the ISO must then interpret the documents to determine the proper operating instructions until the dispute is resolved. However, as stated in the ISO Tariff, the ISO will have no role in interpreting Existing Contracts. Further, we think that it is reasonable for the Participating TO to submit instructions to the ISO for schedule validation. To do otherwise would set up a situation where the ISO could receive conflicting instructions and thereby place the ISO in a position to be the arbitrator between the Participating TO and its customer. This is not, and should not, be the ISO's responsibility. Rather, parties should resort to the ADR procedures of the existing contract or the ISO Tariff to resolve their differences. Finally, we reject Proponents' proposal to eliminate the ADR language of Section 2.4.4.5.4 and replace it with a statement that parties have recourse to any legal remedies available to them. Rather, the use of the ISO's ADR processes should be encouraged, and the restatement of parties' existing legal rights is unnecessary. Accordingly, Proponents' request for rehearing on this matter is denied.

California Independent System Operator Corporation, et. al., 101 FERC P 61,219 at P 25-27 (2002).

Accordingly, the ISO's proposal regarding schedule validation is reasonable and in conformance the current previously approved practice.

3. AEPCO's Concerns

AEPCO expresses concern regarding the vagueness of the validation proposal. AEPCO states there cannot be any legitimate basis for questioning the validity of AEPCO schedules. AEPCO at 6. AEPCO states that the ISO might attempt to engage in a bait and switch after its conceptual proposal is approved. *Id.*

The Commission should not countenance AEPCO's baseless and speculative accusations that the ISO might attempt some "bait and switch" after the conceptual approval for its proposal is obtained. The ISO has no dog in this fight other than its continuing obligation to honor ETCs and, in that context, to provide a means to ensure that ETC schedules conform to their contractual rights. In any event, the ISO expects that further details regarding the validation process will be examined in the context of an open stakeholder forum in 2005 during which the ISO will work with all stakeholders to develop tariff language related to all MRTU issues that will be filed with FERC.

F. Cost Allocation Issues

SDG&E argues that non-ETC rights holders are subsidizing ETC rights holders with respect to the management of congestion. SDG&E at 2. The Southern Cities argue that the costs incurred to honor ETCs in the internal network should be allocated on a zonal basis rather than on a systemwide basis. In other words, such costs should be recovered from non-ETC loads just as they

were prior to formation of the ISO. Southern Cities at 3. MID argues that loads (1) within the ISO Control Area but not served by the ISO grid and (2) not within the ISO control area but served by ETCs that are not subject to ISO congestion management should not be assessed costs associated with the ETC proposal. MID at 6. MID also argues the ISO should not be permitted to spread the costs resulting from its proposal broadly to consumers within and without the Control Area. MID states that the ISO should identify the parties that benefit from the proposal and those that are harmed by the proposal, and only those that benefit from the proposal should pay the costs of honoring ETC contracts.

Under the “perfect hedge” mechanism, for purposes of allocating congestion costs related to Day-Ahead ETC schedules, the ISO will create but not release CRR obligations for ETCs. This will enable the ISO to minimize any risk of a revenue shortfall for non-ETC CRR holders due to application of the “perfect hedge” mechanism in the Day-Ahead market. Because the congestion charges associated with ETC schedules would be absorbed by the CRRs held by the ISO, the impact upon non-ETC CRR holders should be neutral as long as a sufficient number of CRRs are created to hedge Day-Ahead ETC congestion charges. Stated differently, the only risk to non-ETC parties is that the ISO may not set aside the correct quantity of CRRs corresponding to ETC rights. The ISO notes, however, that the structure of CRR release provides for monthly adjustments to CRR allocations. This would enable the ISO to adjust the ETC CRR set-aside in a timely manner if necessary.

For congestion charges related to post-Day-Ahead ETC schedules, there should be no impact on non-ETC SCs. In the Real-Time market, congestion charges are embedded in the locational Real-Time prices and collected from SCs as part of the LMP settlement. However, because there are no CRR payments in the Real-Time, these congestion charges are refunded to the SCs who paid them through a dedicated neutrality account. This is the mechanism the ISO will use for settling Real-Time congestion charges, irrespective of the “perfect hedge.” To implement the “perfect hedge” for post-Day Ahead ETC schedules in this general context, the ISO would not collect congestion charges for these schedules, and would likewise not include them as recipients of the neutrality account refunds. As a result, there should not be any impact on the refund of congestion charges to non-ETC SCs in Real-Time.

With respect to the Southern Cities’ and MID’s comments, the ISO emphasizes that the concept for spreading these post-Day-Ahead ETC congestion costs to all non-ETC load in the system and exports was discussed publicly in the ETC stakeholder process.¹⁷ The strong preference among many stakeholders, as reflected in written comments, was in favor of spreading these costs broadly in this manner because all non-ETC loads throughout the network, including exports, would benefit by the ISO honoring internal ETCs without “setting aside” unscheduled ETC capacity on the internal transmission network. In particular, the ISO’s proposal would greatly improve transmission efficiency,

¹⁷ In its order on MISO’s GFAs, the Commission recognized that its “carve-out” of GFAs with *Mobile-Sierra* clauses, including an exemption from Day-Ahead congestion charges, would result in additional costs for non-GFA transmission customers under the Tariff. *Midwest Independent Transmission System Operator, Inc.*, 108 FERC ¶ 61,236 at P 89.

thereby benefiting all transmission customers. In particular, the ISO's proposal would address the phantom congestion problem that exists today. It benefits all transmission customers to remedy that problem.

G. Issues Raised By LADWP That Pertain To Existing Disputes That Are Unrelated To And Unaffected By The ETC Proposal

LADWP raises concerns about charges it is currently being assessed by the Scheduling Coordinator ("SC") for its ETC. LADWP at 3-4. These charges include Minimum Load Cost Compensation charges and line losses. LADWP expresses a concern that the continued unbundling of costs will result in increased costs being allocated to the ETC rights holder.

The ISO charges that LADWP is currently being assessed by its SC are completely unrelated to the ETC Conceptual Proposal. LADWP is disputing normal load and export charges that previously were paid by SCE as the Scheduling Coordinator for LADWP. This matter relates directly to the interpretation of contracts and is not a policy matter involving the "unbundling" of ISO costs. The status of these charges has been addressed directly by the ISO and LADWP, and the charges are separately the focus of litigation (*Southern California Edison Company*, 105 FERC ¶ 61,276 (2003)). Therefore, this issue is separate from the ETC Proposal and the stakeholder process that preceded it.

H. The Treatment of Losses and Costs Other Than Congestion Will Be Addressed In A Future Stakeholder Proceeding And Are Not Addressed In Or Pre-Judged By This Filing

CCSF argues the ETC proposal fails to honor ETCs because: (1) the ISO proposes to charge losses to ETC holders even though they are currently exempt from losses, (2) only ETC loads will be charged the nodal real time energy price

for Hour-Ahead changes accommodated in Real-Time or Real-Time deviations from DA schedules, and (3) ETCs could be charged with a host of other charges and the ISO has not provided a list of all such charges that might be assessed to ETCs. CCSF at 9-11. SMUD erroneously claims that the “ISO admits in its filing that ETC holders will pay additional costs as a result of the ISO’s proposal.” SMUD at 8. In that regard, the “perfect hedge” proposal only addresses congestion costs, and the ISO’s proposal does not yet address other charges. SMUD at 8-9. For this reason, SMUD argues that the ETC Proposal fails to honor ETC rights.

As the ISO indicated in the December 8 Filing, the instant ETC Proposal does not address the issues of losses and charges other than Congestion. Those issues will be addressed in a future stakeholder process. The ETC Proposal does not address or pre-judge the outcome of those issues and, as such, the ETC Proposal cannot, in and of itself, possibly result in an abrogation of ETC rights. Thus, SMUD has misrepresented the ISO’s proposal, just as it misrepresented the ISO’s proposal with respect to the treatment of unscheduled ETC capacity on the internal transmission network. **The ISO is not proposing in its December 8 Filing that ETC rights holders pay any additional costs. Further, the ISO reiterates its desire to honor ETC rights.** Even SMUD seems to recognize in its protest that not all ETCs prohibit the imposition of additional charges beyond those specified in the ETC. SMUD at 9. In the subsequent stakeholder process, parties will have ample opportunity to argue

that their ETCs do not permit the imposition of additional charges, including losses.

Likewise, the issue of the settlement of ETC load at the Real-Time nodal price or at the Load Aggregation price remains an unresolved implementation detail issue that will be addressed in the stakeholder process leading up to the MRTU Tariff filing. The ISO expects extensive public review of and input into the ETC load settlement issue, as well as other details of the MRTU market design, prior to the filing of the MRTU Tariff.

Regardless of the outcome of this future stakeholder process, the Perfect Hedge concept for reversing Day-Ahead and Real-Time Congestion charges to ETC rights holders will remain in force whether or not ETC load settlement occurs at the nodal or aggregated price. Thus, this particular concern would not impact the mechanism for allocating ETC-related costs, but only the amount of such costs (which costs would not be borne by the ETC rights holder as a result of the perfect hedge mechanism).

Several parties state that the Perfect Hedge should cover more than just congestion charges. For example, MWD argues that "reliability" or "must offer waiver" charges such as those "discovered" in docket No. ER04-835 are being allocated to ETC schedules. MWD at 9. Similarly, CDWR complains of "secret" intra-zonal congestion charges incurred as the result of the dispatch of must offer resources. CDWR at 10-12. The purpose of the ISO's ETC proposal was not to relitigate the appropriateness of the ISO's Amendment No. 60 filing to revise its allocation of minimum load compensation costs included under the Must-Offer

allocation. These issues are being addressed in the hearing scheduled in Docket No. ER04-835, and nothing the ISO's ETC proposal is meant to affect the outcome of that proceeding. Neither MWD nor CDWR should be permitted to use the instant filing to prejudice the outcome of that docket as well.

As noted above, the ISO has sought to address a discrete set of Issues in its December 8 Filing, in order to reasonably proceed on a parallel course with its software development. Amendment No. 60 and the must offer cost allocation proceeding address a myriad of concerns other than ETC rights to ensure that these expenses are assigned based on proper cost-causation principles. The ISO recognizes that both the future stakeholder discussion of ETC cost-related issues as well as its overall preparation of the MRTU tariff will be informed by the outcome of the Amendment No. 60 docket and other ongoing proceedings. For present purposes, it is important that MWD and CDWR have a proper forum to pursue these important issues. Thus, there is no reason to modify or delay implementation of the current ETC proposal to address matters being considered elsewhere.

I. The Need For A Timely Ruling From The Commission And The Impact On Software Development

CMUA contends that a February 2005 decision is premature given the other MRTU design issues (e.g., resource adequacy and market power mitigation) that have yet to be decided. CMUA at 3-4. TANC suggests that the ISO develop the software functionality that would accommodate changes in the way transmission is allocated or reserved. TANC at 6. TANC states that it is impossible to accurately predict how markets technology and policy will develop

over time. Accordingly, TANC recommends that the ISO develop a software platform that will allow for various alternatives such as the reservation of capacity. Both CMUA's and TANC's comments come down to the single issue of developing a specific use software system with the exclusive functionality to "set-aside" ETC capacity on the internal transmission network. The functionality necessary to determine the feasibility of potential ETC schedules is sufficiently unique so that it is not a candidate for inclusion in, or as an addition to, any other market redesign systems that need to be developed to implement the MRTU design. Further, CMUA contends that ISO systems should be flexible and able to adapt to future market developments. CMUA at 3-4.

With respect to CMUA's concern, a conceptual decision on the treatment of ETCs in advance of resolution of other open design issues, would provide the ISO with the knowledge that it need not undertake the effort to design, develop, potentially contract with a vendor and integrate unique ETC software with the other market redesign systems. Because ultimately all software must be integrated and operate as single system, and the various systems must be completed to the point that their individual functionality can be confirmed prior to integration, the last system tested to confirm its individual functionality is the starting point for system integration. Although a decision on some of the elements of the market design (*e.g.*, resource adequacy and market power mitigation) has been deferred, the core systems have previously been defined and contracted with vendors. These elements are already in a state of design and development with the vendor with reasonable assurance that they will be

ready for system integration in 2006. If the Commission were to require the ISO to undertake the extensive, complicated process of developing the unique functionality to “set-aside” ETC capacity on the internal network, it would be better for the ISO to receive that directive sooner rather than later because of the potential impact that such a decision could have on the overall MRTU schedule.

To the extent that TANC is requesting that the ISO develop the functionality for the internal network that the ISO opposes, the ISO notes that it is precisely because of the difficulty in developing such software and the expected cost of such software that the ISO seeks a Commission decision as soon as possible. Attempting to develop this software as a backup if the Commission’s decision were delayed would require the attention of key ISO personnel working on other parts of the MRTU project and would reduce the probability of achieving the planned operational date for MRTU.

J. Allocation of CRRS To ETC Rights Holders

AEPCO contends that the assignment of CRRs directly to the ETC rights holders would be superior to the perfect hedge. AEPCO at 4. AEPCO claims that the Perfect Hedge “still leaves the value of the transmission not utilized by the ETC holder to someone else.” *Id.* Morgan Stanley also advocates allocating CRRs for ETCs on the interties. Morgan Stanley at p. 8.

The ISO disagrees with AEPCO’s and Morgan Stanley that they are entitled to compensation for transmission capacity not utilized. In the December 8 Filing, the ISO cited the Commission’s October 1997 Order noting:

Traditionally, if a customer did not utilize all of its transmission entitlement, the transmission provider and other third-party

customers could utilize that capacity on a non-firm basis. In this instance, the ISO does not provide traditional non-firm transmission service. The ISO will only receive revenues for that capacity if there are Wheeling transactions that utilize the capacity or through Usage Charges. To the extent a rights holder has converted its rights to ISO rights, then it would receive its share of any Wheeling and Usage Charge revenues that arise from the use of its unused transmission entitlement. However, if a rights holder does not convert its rights over to the ISO, then that entity will not be entitled to any such Wheeling or Usage Charge revenues, to the extent that its Non-Converted Rights do not provide for such compensation.

October 1997 Order, 81 FERC at 61,471 (footnote omitted); *see also*

December 8 Filing, Transmittal Letter at 47-49.

If ETC rights holders desire CRRs, then they should convert their ETCs to open access transmission rights under the ISO Tariff. Absent such conversion, they are not entitled to CRRs consistent with Commission precedent. AEPCO is essentially confusing the right to firm service with transmission ownership rights. The fact that a customer is paying for firm service does not preclude the transmission provider from scheduling other service using the customer's unscheduled capacity, nor does it entitle the customer to the revenues associated with such new service.

K. Appendix D Issues

A number of parties provide comments on Appendix D to the December 8 Filing. These comments fall into two general categories: (1) concerns about the specific descriptions of individual agreements; and (2) comments as to whether or not the Commission should rely on the Appendix in reaching its decision.

With regard to the first category of comments, SCE states that two agreements, Rate Schedule 304 and Rate Schedule 421, do not involve service

on ISO facilities and should be removed. SCE at p. 9. SDG&E argues that the appendix should include the Mutual Assistance Transmission agreement and non-firm sharing of excess capacity under the participation agreements for the Southwest Powerlink. SDG&E at p. 3-4. SMUD contends that certain provisions of its ETC's with PG&E should be subject to the Mobile-Sierra standard of modification. SMUD at p. 11. M-S-R notes that it has a dispute with SCE regarding the interpretation of its ETC. M-S-R at p. 5. Similarly, MID identifies its dispute with PG&E regarding the standard of review for its Interconnection Agreement (MID at p. 7), and Metropolitan disagrees with the ISO's use of SCE's description of rights in Rate Schedule 203. SVP notes that the termination date for its ETC is incorrect.¹⁸

With respect to the second category of comments, M-S-R states "the Commission should not rely upon or utilize the data reflected on Appendix D as a vehicle to determine the rights and obligations of the parties to the seventy-plus agreements." M-S-R at p. 3. Instead, M-S-R suggests that the Commission state that its action should not be construed as an acceptance or adoption of the descriptions of the ETC rights reflected in Appendix D. *Id.* Failure to do so, M-S-R suggests would result in rehearing and appellate review, in order to ensure

¹⁸ Midway Sunset states that the ISO failed to include its agreement with PG&E. Midway Sunset at p. 1-2. As noted in Appendix B of the ISO's Transmission Control Agreement, there are two transmission agreements between PG&E and Midway Sunset and Minnesota Methane: (1) FERC Rate Schedule #182 which expires on January 1, 2017, and (2) Service Agreement #1 under FERC Tariff 12 which expires on October 1, 2016. The ISO's Appendix D actually includes both the agreements. The error was in listing the information related to the second contract (2 MW from Yalo to Midway) and an expiration date of October 1, 2016 for the first contract. The correction would be after the listing for Rate Schedule #182 to provide the correct expiration date of October 1, 2017 and to delete the reference to 2 MW and Yalo to Midway.

proper interpretation. *Id.* SVP raises similar issues (SVP at p. 10), and CMUA states that Appendix D should not be relied on. CMUA at p. 7.

The ISO does not suggest that this proceeding or Appendix D be used as a definitive categorization of the rights under the numerous ETCs. Given that the parties to certain of the agreements themselves have disputed the terms of such agreements, the ISO is not seeking a Commission determination on the merits of these claims. The ISO agrees with M-S-R that the need to reach such specific findings could lead to extensive litigation. Indeed, it was to mitigate against such a potential, that the ISO has structured its ETC Proposal to respect the basic rights under the ETCs to schedule delivery of transmission service; provide protection against Congestion costs; and, where necessary, “set-aside” unscheduled ETC capacity to ensure deliverability. Appendix D reflects part of the effort that the ISO has gone through to structure an overall approach that honors ETCs. It is not necessary that the Commission uphold every statement about every ETC to find that the ISO proposal is just and reasonable and does not abrogate Existing Rights. Indeed, no intervenor has pointed to a specific ETC provision that the ISO is failing to honor.

L. Clarification Of Footnote 18

SCE notes in its comments a couple of errors in footnote 18. The first error is the statement that “[t]he GMC settlement agreement in Docket No. ER04-115-000 provides that COTP participants shall not pay the GMC.” SCE also states that the statement “holders of existing rights on the Mohave-El Dorado line” is incorrect. SCE at 8-9. SCE states that, as a general matter, the non-PTO

owners of Mohave El-Dorado hold an ownership interest in the facilities and have the right to use their share of the facilities as owners, not a “holders of existing rights.”

The ISO offers the following corrections to footnote 18. The ISO's 2004-2006 GMC rate structure is contingent upon FERC approval of the 2004 GMC Settlement Agreement in ER04-115-000, et. al. The GMC Settlement Agreement provides that exports from the Mohave Power Plant to Nevada Power and Salt River Project pay 35% of the Core Reliability and Energy Transmission Services - Net Energy components. Separately, COTP GMC payments are contingent on resolution of a rehearing request in EL02-45-000. With respect to the second error identified by SCE, the ISO mistakenly used the phrase “holders of existing rights on the Mohave-El Dorado line” to describe the party to whom the Core Reliability and Energy Transmission Services – Net Energy components discounts accrue. Only SCE receives the discount and, as described above, the discount is only for exports from the Mohave Power Plant to Nevada Power and Salt River Project. This discount applies irrespective of the ownership of or existing contract rights on the Mohave El-Dorado line.

M. Secondary ETC Rights

Powerex requests that the Commission clarify that the rights that apply to ETC rights holders also apply to secondary ETC rights holders. In other words, the rights afforded to ETC rights holders should also extend to Scheduling Coordinators (“SCs”) that schedule on ETC transmission that is resold to that SC. Powerex at 3-4.

To the extent an ETC permits the “resale” of ETC rights to a third-party, the ISO will permit such rights to be utilized by the SC to whom such rights are transferred. However, the ISO will not grant parties any rights that are greater than the rights contained in the ETC. Thus, if a contract does not permit the “re-sale” of such rights to a third party, a “secondary ETC rights holder” would not be permitted to exercise such rights.

III. CONCLUSION

Wherefore, for the foregoing reasons, the ISO respectfully requests that the Commission accept the ETC Proposal in its entirety. The ETC Proposal represents an effective and efficient means of honoring ETCs. Accordingly, the ISO urges the Commission to act expeditiously to enable the ISO to continue with the detailed implementation of the redesigned market.

Respectfully submitted,

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Date: January 26, 2005



January 26, 2005

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: California Independent System Operator Corporation
Docket No. ER02-1656-021

Dear Secretary Salas:

Enclosed please find an electronic filing of Motion for Leave to File Answer and Answer of The California Independent System Operator Corporation To Motions To Intervene, Motions To Reject, Comments, and Protests

Thank you for your attention to this filing.

Respectfully submitted,

/s/ Anthony J. Ivancovich
Anthony J. Ivancovich

Counsel for the California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

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

Dated at Folsom, CA, this 26th day of January, 2005.

/s/ Anthony J. Ivancovich

Anthony J. Ivancovich