II. ARGUMENT

A. ANCILLARY SERVICES

A.1. Does the ISO, and in particular sections 2.5.3.2 and 2.5.20.1 of the ISO Tariff, fail to appropriately credit scheduling coordinators for operating reserves when they purchase firm energy from inside of the ISO Control Area, and is the ISO's failure to provide such credits consistent with the Commission's prior directives in this matter? [Issue No. 73, Docket Nos. EC96-19-008 and EC96-1663-009. Proponents - Sacramento Municipal Utility District ("SMUD"), Enron Power Marketing, Inc. ("Enron"), and Western Power Trading Forum ("WPTF") (collectively and on behalf of certain of its individual members)]

Contrary to Proponents' contentions (*see* Joint Initial Brief on Issue A.1, at 2), the ISO does credit Scheduling Coordinators for Operating Reserves when they purchase firm power from inside the ISO Control Area, as long as the Scheduling Coordinators comply with the Ancillary Services self-provision process set out in the ISO Tariff. *See, e.g.*, ISO Tariff, Sections 2.5.3.2, 2.5.7.4.1, and 2.5.20.2 to 2.5.20.7. The credit is accomplished by the Scheduling Coordinators demonstrating to the ISO, on a pre-scheduled basis, the Energy and reserves for which they have contracted, and by providing Energy bids for the associated reserve resources, so that they can be Dispatched by the ISO as necessary. This is a reasonable crediting process and should be upheld by the Commission.

What SMUD and Southern Cities[10] actually appear to be asking for here is an elimination of Scheduling Coordinators' *obligation* to provide Operating

[10] Southern Cities is comprised of the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California. Joint Initial Brief on Issue A.1, at 1.

Reserves for capacity[11] – they propose that Section 2.5.20.1 of the ISO Tariff be modified to eliminate such an obligation for capacity purchased within the ISO Control Area. *See* Joint Initial Brief on Issue A.1, at 3-4. Apparently, they want Scheduling Coordinators to be able to get the credit for Operating Reserves they have purchased within the ISO Control Area without actually making them available for Dispatch by the ISO. This would be inefficient and unfair, and would potentially reduce the reliability of the ISO Control Area. It would give the Scheduling Coordinators the benefits of self-provision of Ancillary Services, while putting the costs of actual provision of Ancillary Services onto other Scheduling Coordinators. This would defeat the purposes underlying the existing method of properly allocating the costs of Ancillary Services to those that cause the requirements. It could also threaten reliability by denying the ISO access to a portion of the reserves it relies upon to operate the Control Area in accordance with WSCC requirements.

Ancillary Services, both self-provided and awarded in the forward markets, need to be available to the ISO to Dispatch as needed for the ISO Control Area. SMUD and Southern Cities want the credit for self-providing Ancillary Services. They propose to obtain that credit by reducing the Demand on which their obligation is based. However, reducing an entity's established obligation for

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[11] The ISO's total requirements for Operating Reserves are based on WSCC criteria, and consequently are based on the total Load in the Control Area. The ISO's Operating Reserves obligation is apportioned among Scheduling Coordinators in proportion to the Load each serves. Each Scheduling Coordinator must make its share of the ISO Control Area's Operating Reserves obligation available to the ISO for Dispatch. Moreover, regardless of the source of the capacity a Scheduling Coordinator purchases – whether inside or outside the ISO Control Area – the Scheduling Coordinator must meet its proportional obligation as to Operating Reserves, either by self-supplying the capacity, committing the capacity to the ISO, purchasing the capacity from the ISO's market, or by doing these things in combination.

Ancillary Services is not the same as fulfilling that obligation via self-provision. If the proposal of SMUD and Southern Cities were accepted, the ISO would have nothing to Dispatch with regard to the purported "self-provided" Ancillary Services. Under such an approach, the Ancillary Services would not be available to meet and maintain the ISO's operating reliability criteria. This would result in the ISO having to procure a surplus amount of Ancillary Services, and having to spread the additional cost of those Ancillary Services to other Scheduling Coordinators. This would be unjust and unreasonable.

It may be that SMUD and Southern Cities' request arises out of a misunderstanding of the ISO's revision to this section of the Tariff, which was made in response to the Commission's ruling in the October 1997 Order, 81 FERC at 61,507. In that case, the Commission agreed with BPA that a Scheduling Coordinator should not have to "pay twice for Operating Reserves" when the Operating Reserves are provided by firm power imported from outside the ISO Control Area. *Id.* Although the Commission said that a Scheduling Coordinator's Operating Reserve requirement should "be reduced" by the amount of system firm capacity purchased from outside the ISO Control Area, the Commission made it clear that the Scheduling Coordinator is still responsible for providing the reserve Energy. *See id.* at 61,510.

In summary, the ISO does credit Scheduling Coordinators for Ancillary Services they purchase within the ISO Control Area as a part of firm capacity as long as they comply with the self-provided Ancillary Service provisions of the Tariff. This is a reasonable approach and should be upheld by the Commission.

A.2. Does section 2.5.3.3 (e) of the ISO Tariff give the ISO undue discretion to modify its procedures without regard to its Ancillary Services Requirements Protocol, and give the ISO an unfair purchasing advantage over others for Replacement Reserves? [Issue No. 585, Docket Nos. EC96-19-029 and ER96-1663-030. Proponent - Dynegy Power Marketing, Inc. ("Dynegy")]

Section 2.5.3.3 of the ISO Tariff provides that the ISO will determine the amount of Replacement Reserves it purchases based on consideration of a number of listed factors. Dynegy originally raised this issue to challenge subsection (e) of that Tariff section, which authorizes the ISO to consider "such other factors affecting the ability of the ISO to maintain System Reliability as the ISO may from time to time determine." In its initial brief, however, Dynegy presents a different argument, contending that the "rational buyer" protocol proposed by the ISO in Amendment No. 14 and approved by the Commission in *AES Redondo Beach, L.L.C., et al.,* 87 FERC ¶ 61,208 (1999) ("May 1999 Order"), gives the ISO undue discretion in purchasing Ancillary Services, resulting in an "unfair purchasing advantage over other potential competitors."[12]

This argument fails in a number of respects. First, it has nothing to do with Section 2.5.3.3, which was not modified in connection with the rational buyer proposal. The rational buyer protocol was implemented principally through the addition of Section 2.5.3.6 to the ISO Tariff, authorizing the ISO to increase its purchases of one Ancillary Service that could substitute for another, and thereby

[12] Initial Brief of Dynegy at 7. Dynegy apparently modified its position, as well as the agreed description of this issue, because it believes that subsection (e) was deleted from Section 2.5.3.3 by Amendment No. 14. *Id.* at 7 n.3. Dynegy, however, is mistaken: Amendment No. 14 did not modify Section 2.5.3.3 (nor, for that matter, did any other amendment) and, in particular, subsection (e) remains part of the ISO Tariff.

reduce its total Ancillary Services procurement costs.[13]

Second, Dynegy's challenge to the rational buyer protocol is untimely and beyond the scope of this proceeding. The Commission approved the rational buyer approach to Ancillary Services procurement in its May 1999 Order, over objections raised by Dynegy (then calling itself "Electric Clearinghouse, Inc."). Dynegy did not seek rehearing of the May 1999 Order's ruling. Its attempt to reargue in this proceeding its objections to the rational buyer approach, which the Commission considered and rejected, amounts to an untimely request for rehearing of the May 1999 Order.[14]

Third, even if Dynegy's objections to the rational buyer approach were properly before the Commission again, they are unfounded. Not only did the Commission approve the rational buyer approach in the May 1999 Order, but it also required the New York ISO to utilize a rational buyer protocol for its own Ancillary Services markets. *See Central Hudson Gas & Electric Corp.,* 86 FERC ¶ 61,062, 61,226-27, *order on reh'g*, 88 FERC ¶ 61,138 (1999). Dynegy's renewed objections present no basis for revisiting this position. The ISO does not operate Ancillary Services markets to compete with Market Participants, but to enable Scheduling Coordinators who are unable or unwilling to self-provide Ancillary Services or to procure the necessary capacity in bilateral

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[13] *See* Amendment No. 14 filing, Tab E (Rational Buyer black-lined Tariff Sheets), Docket No. ER99-1971-000 (Mar. 1, 1999).

[14] *See Transcontinental Gas Pipe Line Corp., et al.*, 66 FERC ¶ 61,274, at 61,764 (1994), *citing Boston Edison Co.*, 23 FERC ¶ 61,176 (1983) and *Montana Dakota Utilities*, 23 FERC ¶ 61,418 (1983) ("[Proponent's] . . . request, which it styled a request for clarification, was simply an attempt to circumvent the statutory provisions for rehearing. This the Commission will not allow.").

transactions to obtain Ancillary Services capacity in an open and efficient market. The use of the rational buyer approach does not give the ISO's Ancillary Services markets an "advantage" over the self-provision of Ancillary Services or bilateral transactions. Scheduling Coordinators who supply their own Ancillary Services capacity, or procure Ancillary Services capacity bilaterally, also enjoy the flexibility that the rational buyer approach gives to the ISO: they can use capacity that meets the specifications for a more restrictive Ancillary Service, such as Spinning Reserve, to meet their obligations for a less restrictive or lower quality service, such as Non-Spinning Reserve.

Neither does the rational buyer approach affect the quantities of different Ancillary Services that a Scheduling Coordinator must supply to fulfill the obligations associated with serving its Load. Regardless of how the ISO adjusts its procurement of different Ancillary Services under the rational buyer approach to take advantage of more favorable prices, a self-providing Scheduling Coordinator need only supply its proportionate share of each required Ancillary Service. The ISO also notes that the rational buyer approach is consistent with the obligation of an RTO to be the provider of last resort of Ancillary Services. *See* Order No. 2000, FERC Stats. and Regs., Regs. Preambles ¶ 31,089, 31,140.

In sum, Dynegy's attempt to renew its objections to the rational buyer approach to Ancillary Services procurement is off point, untimely, and unsupported.

A.3. With respect to Voltage Support:

a. Does Ancillary Services Requirements Protocol section 7.3 ("ASRP") need to be clarified? [Issue No. 96, Docket Nos. EC96-19-006, EC96-19-007, EC96-19-008, ER96-1663-007, ER96-1663-008, and ER96-1663-009. Proponents - Dynegy and Cogeneration Association of California ("CAC")]

Unresolved Issue No. 96 was raised by Dynegy in comments in Docket Nos. EC96-19-006 and ER96-1663-007, in November 1997. Pursuant to the Commission's September 11, 1998 Order in Docket No. ER98-3760-000, *California Independent System Operator Corporation*, 84 FERC ¶ 61,217, 62,048 (1998), Dynegy identified this issue as remaining in dispute.[15] As reflected in Attachment C to the Report on Outstanding Issues filed in this matter on March 11, 1999, Dynegy and the ISO reached a proposed settlement based on the following changes to the ISO Tariff:

> Change ASRP 7.3 as follows: Standard for Voltage Support: Distribution and Location. ~~Each Generator, Participating TO and UDC shall ensure that sufficient Voltage Support is available in the vicinity of each designated substation bus to maintain voltage within the Voltage Limits prescribed by the ISO in its voltage schedules for each Settlement Period. Each Generator, Participating TO and UDC shall provide sufficient reactive supply in each local area to take into account real power losses created by reactive power flow on the system. Reactive power flow at Scheduling Points shall be maintained within a power factor bandwidth of 0.97 lag to 0.99 lead.~~ The ISO shall determine on an hourly basis for each day the quantity of Voltage Support required at various locations on the ISO Controlled Grid to maintain voltage levels and reactive margins within WSCC and NERC criteria using a power flow study based on the quantity and location of scheduled Demand. The ISO shall issue daily voltage schedules based on that determination to any Generators and Loads that are requested to change their voltage levels. Each Generating Unit owned by a Participating Generator shall maintain the ISO specified voltage schedule at the transmission interconnection points to the extent possible while operating within the power factor range required by Section 2.5.3.4

[15] *See* the Report on Outstanding Issues filed in the Unresolved Issues dockets on March 11, 1999, at Appendix B.

(within a band of 0.90 lag and 0.95 lead unless otherwise specified in an agreement specified in that Section). Other Generating Units shall operate within the power factor range required by Section 2.5.3.4. Each Load directly connected to the ISO Controlled Grid shall maintain voltage levels and power factors as required under Section 2.5.3.4 (within a power factor band of 0.97 lag to 0.99 lead). Each UDC shall maintain reactive power flow at the Scheduling Points with which it is interconnected with the ISO Controlled Grid within the range of 0.97 lag to 0.99 lead, unless otherwise specified in its UDC agreement.

Dynegy continues to support the proposed settlement as a mutually agreeable resolution of this issue. Joint Initial Brief on Issue A.3.a, at 2. While the ISO believes that this Tariff provision was just and reasonable as filed and that no changes are necessary, the ISO continues to support the compromise reached with Dynegy. However, the additional relief requested by EPUC/CAC is unwarranted.[16]

The ISO believes that EPUC/CAC lacks standing to pursue this issue. EPUC/CAC was accorded the same opportunity as the other participants to identify specific issues to be included in the matrix that would serve as the basis for settlement discussions. EPUC/CAC declined to do so.[17] Moreover, unlike most of the entities that identified issues, EPUC/CAC failed to file a timely intervention and protest in response to either the ISO's June 1, 1998 Compliance filing or July 15, 1998 Clarification filing. While EPUC/CAC did raise certain issues relating to the ISO Tariff in its comments of June 1, 1997 and

[16] EPUC/CAC recommends that Section 7.3 of the ASRP be amended as follows:

> (1) to apply only to Participating Generators that choose to supply Voltage Support to the CAISO [i.e., the ISO] (regardless of whether the generator may already provide support to the UDC pursuant to the terms of a pre-existing Power Purchase Agreement); and (2) to remove any authority by the CAISO to issue unilateral orders except in an emergency.

Joint Initial Brief on Issue A.3.a, at 2.

[17] Approximately twenty other participants, representing a cross section of state and federal agencies, municipal utilities, investor-owned utilities, consumer groups, independent Generators, and power marketers, all identified issues.

September 2, 1997, EPUC/CAC had never contested the ISO's requirements regarding Voltage Support or the ISO protocols, including the ASRP, when they were filed at the Commission.[18] In its April 28, 1999 Order, the Commission found that where EPUC/CAC had failed to intervene or protest in prior proceedings it would not require the ISO to recategorize issues that had been withdrawn. *California Independent System Operator Corporation*, April 1999 Order, 87 FERC at 61,423. The same rationale should apply to issues that have been settled when EPUC/CAC does not contend that it is being prejudiced by the revised language but instead belatedly seeks to expand the scope of the original issue. Accordingly, the Commission should accept the revisions agreed to by Dynegy and the ISO and should reject EPUC/CAC's belated attempt to seek additional changes.

Even if it has standing to raise its arguments, EPUC/CAC's concerns are unfounded. EPUC/CAC states that QF operations were not contemplated in the ISO Tariff. Joint Initial Brief on Issue A.3.a, at 3. This is incorrect. For example,

[18] According to EPUC/CAC, its June 6, 1997 comments were aimed to achieve the following proposed modifications to the proposed tariffs: (1) to minimize the barriers to entry created for Scheduling Coordinators and to maximize the flexibility for customers and their supporters in their use of Scheduling Coordinators; (2) to clarify and enhance the rules governing transmission expansion by individual project sponsors; (3) to ensure the development of a competitive market for Ancillary Services through the use of bid floors; (4) to resolve conflicts between the Commission's open access transmission policy and state-jurisdictional standby service tariffs; (5) to urge the Commission to mandate further disclosure of critical information under proposed Must-Run Agreements and to modify provisions of these agreements to prevent below-cost bidding and manipulation of market rules; (6) to enhance the proposed market power monitoring program; (7) to modify the ISO governance principles; (8) to prevent overreaching by the ISO in obtaining information from Generators; and (9) to modify provisions of the wholesale distribution tariffs. Comments of the Energy Producers and Users Coalition and the Cogeneration Association of California On the August 15, 1997, Submittals of the California Independent System Operator Corporation and the California Power Exchange Corporation, Docket Nos. EC96-19-003 and ER96-1663-003 (Sept. 2, 1997), at 2-3. EPUC/CAC's stated concern about the relationship between the ISO and Generators was that "the definition of a generator for the purposes of these protocols may permit the ISO to request and obtain data from generators that is unnecessary in the day-to-day grid operations." *Id.* at 15. The Commission found EPUC/CAC's proposal to be "inappropriate and unworkable." October 1997 Order, 81 FERC at 61,514.

Section 5.1.5 of the ISO Tariff, which concerns "Existing Contracts for Regulatory Must-Take Generation," states as follows:

> Notwithstanding any other provision of this ISO Tariff, the ISO shall discharge its responsibilities in a manner which honors any contractual rights and obligations of the parties to contracts, or final regulatory treatment, relating to Regulatory Must-Take Generation of which protocols or other instructions are notified in writing to the ISO from time to time and on reasonable notice.

Regulatory Must-Take Generation is defined in the ISO Tariff to include

> [t]hose Generation resources identified by CPUC, or a Local Regulatory Authority, the operation of which is not subject to competition. These resources will be scheduled by the relevant Scheduling Coordinator directly with the ISO on a must-take basis. Regulatory Must-Take Generation includes *qualifying facility* Generating Units as defined by federal law, nuclear units and pre-existing power purchase contracts with minimum energy take requirements.[19]

More directly with respect to this issue, QFs were also specifically considered in the ISO Tariff provisions concerning Voltage Support:

> 2.5.3.4 Voltage Support.
>
> The ISO shall determine on an hourly basis for each day the quantity and location of Voltage Support required to maintain voltage levels and reactive margins within WSCC and NERC criteria using a power flow study based on the quantity and location of scheduled Demand. The ISO shall issue daily voltage schedules which are required to be maintained for ISO Controlled Grid reliability.
>
> All Participating Generators shall maintain the ISO specified voltage schedule at the transmission interconnection points to the extent possible while operating within the power factor range specified in their interconnection agreements *or*, *for Regulatory Must-Take Generation, Regulatory Must-Run Generation and Reliability Must-Run Generation consistent with existing obligations*. For Generating Units, that do not operate under one of these

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[19] ISO Tariff, Appendix A, definition of "Regulatory Must-Take Generation" (emphasis added).

> agreements, the minimum power factor range will be within a band of 0.90 lag (producing VARs) and 0.95 lead (absorbing VARs) power factors. Participating Generators with Generating Units existing at the ISO Operations Date that are unable to meet this operating power factor requirement may apply to the ISO for an exemption. Prior to granting such an exemption, the ISO shall require the Participating TO or UDC to whose system the relevant Generating Units are interconnected to notify it of the existing contractual requirements for voltage support established prior to the ISO Operations Date for such Generating Units. Such requirements may be contained in CPUC Electric Rule 21 or the Interconnection Agreement with the Participating TO or UDC. The ISO shall not grant any exemption under this Section from such existing contractual requirements. The ISO shall be entitled to instruct Participating Generators to operate their Generating Units at specified points within their power factor ranges. Generators shall receive no compensation for operating within these specified ranges.
>
> If the ISO requires additional Voltage Support, it shall procure this either through Reliability Must-Run Contracts or, if no other more economic sources are available by instructing a Generating Unit to move its MVar output outside its mandatory range. Only if the Generating Unit must reduce its MW output in order to comply with such an instruction will it be compensated in accordance with Section 2.5.18.

(Emphasis added.) EPUC/CAC's assertions are thus unfounded. Concerns related to QFs and other Regulatory Must-Take Generation are addressed in the ISO Tariff, including the provisions pertaining to Voltage Support.

EPUC/CAC contends that the ASRP requirement to operate under automatic voltage regulation is not necessary for a Generator to provide reactive power in support of the local system, and that this requirement "ignores years of historical operating experience." *See* Joint Initial Brief on Issue A.3.a, at 5. The Commission, however, has concluded that these provisions are a "necessary and critical requirement." As explained in the October 1997 Order:

> We disagree with AES Pacific and IEP that Section 2.5.3.4 of the ISO Tariff inappropriately provides that Generating Units provide VAR support without compensation. Section 2.5.3.4 of the ISO Tariff provides that Generating Units maintain a minimum power

> factor range within a band of 0.90 lagging and 0.95 leading and that generators will receive no compensation for operating within these specified ranges. We find that this is a necessary and critical requirement for all generators connected to the ISO Controlled Grid. Without such a requirement, the ISO will be unable to fulfill its responsibilities as Control Area Operator to maintain system stability. This provision merely specifies a broad power factor range requirement. To the extent a generator cannot meet the operating power factor requirement, the generator can apply to the ISO for an exemption from this requirement.

October 1997 Order, 81 FERC at 61,499-500. EPUC/CAC never sought rehearing of this determination. It should not be permitted to circumvent the statutory requirements for rehearing.[20] As the Control Area operator, the ISO must maintain the ISO Controlled Grid within the limits of Good Utility Practice in accordance with NERC and WSCC requirements.

EPUC/CAC states that "[a] Generator has physical limits with respect to the voltage support it can provide without adversely impacting equipment" and "there are QF operations where a curtailment of thermal supply would pose a safety concern of dramatic consequence." Joint Initial Brief on Issue A.3.a, at 4. However, all Generators, including QFs, are free to specify both a "minimum operating limit" and any operating "limitations" applicable to their Generating Unit.[21] This allows the facility to indicate to ISO operating personnel any technical operating restrictions on the ability of the Generating Unit to deliver power to the ISO. Moreover, as the Commission recognized in its October 1997 Order:

> We find that the requirement that participants comply with all ISO orders except those that would result in impairment to public health and safety to be reasonable. With regard to intervenor concerns about potential damage to their facilities, we note that the ISO will

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20 *See Transcontinental Gas Pipe Line Corp.*, 66 FERC at 61,764.

21 *See* Attachment 1, which contains a sample Schedule 1 of a Participating Generator Agreement.

> follow good utility practice in operating the system and will comply with all NERC, WSCC and other reliability criteria.

October 1997 Order, 81 FERC at 61,456.

EPUC/CAC's statement that "[t]he CAISO is now seeking to impose requirements as though the QF load is part of its Control Area and part of its Firm Load Obligations," Joint Initial Brief on Issue A.3.a, at 3, is both unrelated to the issue of Voltage Limits for Generators and misleading. EPUC/CAC's concern here is not with the ISO's Voltage Support requirements, but rather with Section 2.2.4.3 of the Metering Protocol ("MP") regarding the prohibition against netting Load. The ISO is not planning any modifications of that provision at this time.[22]

EPUC/CAC incorrectly claims that these Voltage Support issues are being addressed in Docket Nos. ER98-997-000 and ER98-1309-000 concerning the QF PGA. *Id.* at 4. Attachment 2 contains the testimony of the ISO and EPUC/CAC that has been filed in the QF PGA case. The issue of Voltage Support as defined in the ISO's Tariff and protocols is not discussed in that testimony, for good reason. The proper place for these issues to be raised was in the dockets in which the ISO Tariff and protocols sections defining these obligations were filed with the Commission. As noted above, EPUC/CAC failed to raise these issues in response to these ISO Tariff and protocols submissions or on rehearing of the Commission's October 1997 Order.

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[22] As discussed below with respect to Issue F.2, EPUC/CAC is apparently concerned that the meter data needed by the ISO for system operation will at some point in the future be used to allocate additional costs such as the ISO's Grid Management Charge ("GMC"). As provided for by a currently effective GMC settlement, Qualified Loads (i.e., Loads served by QF Energy that is generated on or distributed by the QF generator through private property or over dedicated distribution facilities solely for the QF's own use, the use of its tenants, or the use of two other corporations located on adjacent property) are exempted from the GMC. ISO Tariff, Appendix F, Schedule 1. The basis upon which the GMC is assessed may change, of course, depending on the outcome of the filing that the ISO is required to make before January 1, 2001. EPUC/CAC is simply trying to limit its members' potential exposure to these costs by eliminating the database upon which they would be assessed.

Accordingly, the ISO respectfully requests that the Commission find that the revision to the ISO Tariff supported by Dynegy and the ISO is reasonable. The ISO further requests that the Commission find that the additional requested relief sought by EPUC/CAC is untimely and unnecessary.

b. With respect to ASRP 7.3 and section 2.5.3.4 of the ISO Tariff, are power factors for Participating Generators not operating under specified agreements improperly inconsistent with the power factors of section 2.5.3.4 and should ASRP 7.3 address Voltage Support requirements for Loads as does section 2.5.4.3? [Issue No. 326, Docket Nos. EC96-19-006, EC96-19-008, ER96-1663-007, and ER96-1663-009. Proponent - CAC]

This issue has been withdrawn. Joint Initial Brief on Issue A.3.b, at 1.

c. Should Participating Generators that do not meet minimum ISO Tariff criteria for Voltage Support be required to obtain Ancillary Services to make up their shortfall, and should Participating Generators that are called upon by the ISO to exceed minimum ISO Tariff Voltage Support criteria be compensated for so doing? [Issue No. 353, Docket Nos. EC96-19-003 and ER96-1663-003. Proponents - California Department of Water Resources ("DWR") and CAC].

(1) EPUC/CAC Issues.

The ISO has addressed EPUC/CAC's position that the ISO Tariff has not been designed to accommodate QFs in the relation to Issue A.3.a, above. As to Issue A.3.c, EPUC/CAC repeats its arguments: that QF operations were not contemplated in the Tariff; that "there are QF operations where a curtailment of thermal supply would pose a safety concern of dramatic consequence"; and that these Voltage Support issues are being addressed in Docket Nos. ER98-997-000 and ER98-1309-000 concerning the QF Participating Generator Agreement. Joint Initial Brief on Issue A.3.c, at 4. As discussed above in relation to Issue A.3.a, EPUC/CAC's claims are without merit.

Next, EPUC/CAC takes issue with the requirements of Section 2.5.3.4 of the ISO Tariff. *Id.* at 5. EPUC/CAC argues that (1) "[i]t is inappropriate for Generators to be penalized if their units cannot operate within the full power factor range because they have not undertaken a contractual obligation to do so"; and that (2) "to the extent the ISO-mandated 'minimum power factor range' imposes additional costs on a new QF, it is contrary to the requirement of State and Federal statutory requirements to 'encourage development' of QF facilities." *Id.* EPUC/CAC's claims fail to withstand scrutiny. Section 2.5.3.4 of the ISO Tariff respects the obligations contained in existing Interconnection Agreements. Moreover, the Public Utilities Regulatory Policies Act of 1978[23] ("PURPA"), which governs QF facilities, does not exempt QFs from incurring reasonable costs to accommodate their Interconnection to the utility grid.

The full text of Section 2.5.3.4 of the ISO Tariff is provided in this brief's discussion of Issue A.3.a, above. It reads in pertinent part as follows:

> All Participating Generators shall maintain the ISO specified voltage schedule at the transmission interconnection points to the extent possible while operating within the power factor range specified in their interconnection agreements *or, for Regulatory Must-Take Generation, Regulatory Must-Run Generation and Reliability Must-Run Generation consistent with existing obligations*.

(Emphasis added). As shown in the discussion of Issue A.3.a, above, Regulatory Must-Take Generation includes QFs. Thus, by its terms, the ISO Tariff respects existing QF Interconnection obligations.

Regarding the reasonableness of Section 2.5.3.4, the Commission responded to the comments of the Independent Energy Producers Association, another group that represents QF interests:

[23] Pub. L. No. 95-617, 92 Stat. 3117 (codified as amended in sections of 15 U.S.C., 16 U.S.C., and 43 U.S.C.).

> We disagree with AES Pacific and IEP that Section 2.5.3.4 of the ISO Tariff inappropriately provides that Generating Units provide VAR support without compensation. Section 2.5.3.4 of the ISO Tariff provides that Generating Units maintain a minimum power factor range within a band of 0.90 lagging and 0.95 leading and that generators will receive no compensation for operating within these specified ranges. We find that this is a necessary and critical requirement for all generators connected to the ISO Controlled Grid. Without such a requirement, the ISO will be unable to fulfill its responsibilities as Control Area Operator to maintain system stability. This provision merely specifies a broad power factor range requirement. To the extent a generator cannot meet the operating power factor requirement, the generator can apply to the ISO for an exemption from this requirement.

October 1997 Order, 81 FERC at 61,499-500. As noted in regard to Issue A.3.a, EPUC/CAC did not seek rehearing of this determination. It should not be permitted to circumvent the statutory provisions for rehearing. In the October 1997 Order, the Commission also concluded that "Participating Generators unable to meet the minimum standards for voltage support should not lean on the ISO or other Market Participants," that such Participating Generators "must either pay for their ancillary service requirements or self-provide them from another source." *Id.* at 61,499. It is not a violation of PURPA to impose reasonable obligations on QF Generators to prevent inappropriate cost-shifting onto other Market Participants. The Commission should reject the proposed modification to Section 2.5.3.4 of the ISO Tariff proposed by EPUC/CAC.

(2) <u>DWR Issues.</u>

DWR argues that those entities that do not meet the VAR requirements should not be permitted to "lean" upon those that do. Joint Initial Brief on Issue A.3.c, at 8-9. As noted above, the Commission's October 1997 Order specifically endorsed this proposition. DWR cites the interim agreement between the ISO, PG&E, and SMUD, which was accepted by the Commission in

Docket No. ER00-879-000,[24] and states that it does not know if the ISO has entered into agreements exempting certain Generators from the generally applicable standards. Joint Initial Brief on Issue A.3.c, at 9. The ISO has not done so. The interim agreement cited by DWR established a mechanism by which the information concerning the Generation and Load internal to SMUD's Service Area is communicated to and accounted for by the ISO. It does not exempt Generators from the requirements of Section 2.5.3.4 of the ISO Tariff. The ISO acknowledges that, whether interim or not, it should have filed the agreement in a timely manner with the Commission and apologizes for inadvertently not having done so.[25] More generally, the ISO has not granted any exemptions under Section 2.5.3.4. The ISO agrees that if it does grant such an exemption, it will post that information on the ISO Home Page in a manner similar to that in which it posts information concerning exemptions from the ISO's metering requirements.

Next, DWR argues that Section 2.5.18 of the ISO Tariff should be clarified regarding the following: whether a Generator may deviate from its initial VAR Set Point even though the Generator must still meet the required power factor range; how the ISO will distribute short-term voltage obligations among Generators meeting the same locational requirements; and how often such "short-term" Voltage Support will be necessary. Joint Initial Brief on Issue A.3.c, at 10-11. DWR notes that it raised the issues in its June 6, 1997 comments in the Unresolved Issues Dockets. *Id.*

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[24] *California Independent System Operator Corporation*, 90 FERC ¶ 61,117 (2000).

[25] DWR's concern stems from a footnote in the filing letter for the interim agreement described above, which was filed on December 22, 1999. Footnote 6 of the filing letter noted that the documents were executed with a "Privileged and Confidential" footer. The footnote, however, erroneously attributed the footer to the interim nature of the document. The fact that the document was executed and filed, despite the footer, was an indication of the need to get the document signed expeditiously, as ISO operations had commenced.

DWR fails to acknowledge that the Commission rejected these clarification requests in its October 1997 Order:

> We reject DWR's request for clarification regarding section 2.5.18 of the ISO Tariff. DWR requests that the ISO clarify that short-term voltage support will be procured only when voltage support procured on an annual basis is insufficient. As explained above, section 2.5.3.4 clearly provides that the ISO will not call upon Generating Units to operate outside of their mandatory power factor range (short-term voltage support) unless no other economic sources are available. In addition, we find that it is inappropriate to require the ISO to specify how often short-term voltage support will be procured. The ISO cannot reasonably predict when it will need to procure additional incremental voltage support. With regard to DWR's recommendation that ISO Tariff section 2.5.18 provide that suppliers of long-term voltage support will still be compensated if the ISO relies on short-term voltage support service, we find that such provisions are appropriately addressed in the contract between the long-term voltage support service provider and the ISO.

October 1997 Order, 81 FERC at 61,499. DWR failed to seek rehearing of the Commission's ruling on Section 2.5.18 of the ISO Tariff.[26] It may not, through this proceeding, submit what amounts to an untimely rehearing request.[27]

Neither EPUC/CAC nor DWR has offered sufficient justification to modify either Section 2.5.3.4 of Section 2.5.18 of the ISO Tariff. Rather than attempting to take issue with the Commission's prior findings with respect to these provisions, both proponents fail even to discuss the prior order. The relief requested by EPUC/CAC and DWR should be denied.

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[26] *See* Request for Clarification, or in the Alternative, Rehearing of the Department of Water Resources of the State of California, Docket Nos. EC96-19-009, *et al.* (Dec. 1, 1997).

[27] *See Transcontinental Gas Pipe Line Corp., et al.*, 66 FERC at 61,764 ("[Proponent's] . . . request, which it styled a request for clarification, was simply an attempt to circumvent the statutory provisions for rehearing. This the Commission will not allow.").

A.4. Has the ISO unreasonably precluded certain entities from providing competitive Black Start and Voltage Support Services to the ISO Grid and should the ISO Tariff (including sections 2.5.3.4 and ASRP 7.5.1) be revised to require competitive procurement of Black Start and Voltage Support Services? [Issue No. 189, Docket Nos. EC96-19-017 and ER96-1663-018, and Issue No. 319, Docket Nos. EC96-19-029 and ER96-1663-030. Proponents - Cities of Anaheim, Colton, Riverside, Azusa and Banning, California ("Southern Cities"), DWR, and MWD]

Proponents assert that the Commission, in the October 1997 Order, conditionally accepted the ISO Tariff based on its "shared understanding" that all resources would have the ability to compete to provide the ISO with Voltage Support service. Joint Initial Brief on Issue A.4, at 5. However, the Commission rejected the recommendation of the Bonneville Power Administration ("BPA") to amend Section 2.5.18 of the ISO Tariff to provide that the ISO may obtain Voltage Support from any Generator connected to the ISO Controlled Grid, even if the Generator has not submitted Adjustment Bids. In doing so, the Commission recognized that the ISO Tariff *already* provided the ISO the discretion to procure Voltage Support from resources other than those that submit decremental Adjustment Bids, and did not require that the ISO competitively procure such services. *See* October 1997 Order, 81 FERC at 61,496-97. Thus, the Commission's October 1997 Order recognized that the ISO must have the ability to procure necessary Voltage Support as needed, and should not be constrained to only those resources that have submitted Adjustment Bids. Voltage Support is a locational requirement that can only be satisfied by certain units.

Proponents also claim that the October 1997 Order's rejection of recommendations that the ISO allow the self-provision of Black Start service supports the proposition that the Commission intended the ISO to competitively procure such service. *See* Joint Initial Brief on Issue A.4, at 5-6. However, what the Commission in fact held was that as the ISO gains more experience with the technical requirements and specifications for Black Start service, the ISO may remove the restriction on the self-provision of such service and decide how best to procure Black Start service for the entire Control Area. October 1997 Order, 81 FERC at 61,498.

Moreover, Proponents rely heavily on the fact that, prior to start-up and subsequent to the October 1997 Order, the ISO filed Tariff changes for the purpose of clarifying that the ISO would procure Voltage Support and Black Start services from RMR units. While Proponents recognize that the ISO did not have sufficient time to implement a competitive procurement process by its anticipated operations date (*see* Joint Initial Brief on Issue A.4, at 9), Proponents inappropriately interpret the ISO's proposed Tariff changes as being "intended to eliminate *any* potential ISO procurement of Voltage Support and Black Start contract services from any entity other than RMR Units." *See id.* at 7. This is not the case. The fact that the ISO Tariff currently provides that it will procure Voltage Support and Black Start services from RMR units does not preclude future competitive procurement of those services. Proponents fail to recognize two important considerations: (1) that the October 1997 Order directed the ISO to remove from its Tariff all provisions that would not be effective as of the ISO Operations Date (October 1997 Order, 81 FERC at 61,478); and (2) that the ISO has the right, under the Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d (1994), to apply unilaterally to amend the ISO Tariff (*see* ISO Tariff, Section 19). As soon as the ISO is in a position to competitively procure and financially settle Voltage Support and Black Start services based on input from a stakeholder process it expects to conduct, the ISO will file to amend its Tariff to so provide.

Further, Proponents dismiss the fact that the ISO included the provision of Voltage Support and Black Start services in its Local Area Reliability Service ("LARS") 2000 initiative. *See* Joint Initial Brief on Issue A.4, at 11. Proponents claim that competitive procurement through the LARS process is somehow inferior because "successful candidates are expected to execute a Reliability Must-run [sic] Agreement in a form consistent with the Commission-approved *pro forma* RMR Agreement." *Id.* What Proponents fail to recognize is that all entities are able to participate in the LARS competitive procurement process and that Voltage Support and Black Start services are location-dependent, and therefore it is necessary to enter into cost-based RMR Agreements with each provider in order to prevent such providers from exercising market power. Even if the ISO were to procure Voltage Support and Black Start Service via another mechanism (e.g., a periodic auction), the ISO would still have to address the market power issue.

Proponents are correct that the ISO has always intended to obtain Voltage Support and Black Start services pursuant to a competitive process. As pointed out by Proponents, the ISO originally intended to procure any additional voltage

or reactive power support needs (i.e., the needs that are in addition to those already provided by all Generators and Load satisfying certain minimum power factor requirements) through a competitive auction. In addition, the ISO originally intended to procure Black Start service through an annual auction.
See id. at 2-3. However, at that time the technical requirements and specifications for such services were unclear, and the mechanisms through which such services could be procured and financially settled had not been developed. Therefore, prior to the ISO Operations Date, it was determined that any additional Voltage Support needs and Black Start services would be provided under then-effective RMR Agreements. Since the ISO's Voltage Support and Black Start requirements are local in nature (i.e., location-dependent) and since Reliability Must-Run Units are designated for the purposes of providing local area support, the ISO reasonably determined at that time to procure such services under the RMR Agreements.

However, the ISO never intended to procure, on an indefinite basis, Voltage Support or Black Start services from Reliability Must-Run Units. The ISO has always reasoned that such services could technically be provided from other resources in the state. This is evident from the LARS 2000 initiative. The LARS initiative is intended to explore cost-effective alternatives to existing Reliability Must-Run Generation in the provision of services provided under the RMR Agreements. The LARS process considers such alternatives as non-Reliability Must-Run Generation, transmission project alternatives, and load-based alternatives, such as demand-side management programs. As provided in the

LARS 2000 Request for Proposals ("RFP"), the ISO is willing to consider all proposals to provide such Voltage Support and Black Start services that may be submitted under this RFP. Yet not a single entity responded to the LARS RFP offering to supply such services. While the ISO recognizes the difficulty in responding to a solicitation when the technical requirements and specifications of the services being procured have not been developed, the ISO is and has always been willing to entertain any proposal that will enable the ISO to procure a service at least cost.

Finally, Proponents assert that because of the ISO's continued delay in implementing a competitive procurement for Voltage Support and Black Start, Proponents "are subject to the ISO's artificially increased cost of obtaining such services." Joint Initial Brief on Issue A.4, at 11-12. Proponents ignore the fact that to date the ISO has procured such services under cost-based RMR Contracts. Moreover, the ISO, on an annual basis, has solicited cost-effective alternatives to the RMR Agreements and the services provided thereunder. Therefore, the Commission should deny Proponents' requested relief.

In conclusion, as evidenced by the LARS 2000 solicitation, the ISO has not precluded any entity from providing Voltage Support or Black Start service to the ISO. Moreover, the ISO Tariff, as approved by the Commission in the October 1997 Order, already provides the ISO with the discretion to competitively procure such services from any Market Participant. Therefore, no change to the ISO Tariff or protocols is warranted.

A.5 Should section 5.6.2 of the Tariff be modified to remove the words System Resource? [Issue No. 283, Docket Nos. EC96-19-029 and ER96-1663-030. Proponents – Bonneville Power Administration ("BPA") and CAC]

This issue has been withdrawn. Joint Initial Brief on Issue A.5, at 1.

A.6. Is the ISO's use of out-of-market purchases based on extra-tariff criteria as opposed to ancillary services and Supplemental Energy bids in price order, just and reasonable? [Issue No. 491, Docket Nos. EC96-19-029 and ER96-1663-030. Proponents - Enron and WPTF]

WPTF and Enron complain that at times "the CAISO uses out-of-market purchases instead of Ancillary Services and Supplemental Energy bids in price order, and uses extra-tariff criteria in accepting and dispatching the resources." Joint Initial Brief of WPTF and Enron on Issues A.6, B.5.f, E.5, L.1, and L.8, at 6. As an initial matter, despite WPTF and Enron's use of the term "out-of-market," the discussion in their initial brief does not address out-of-market ("OOM") purchases at all.[28] Instead, the discussion exclusively concerns Generation Dispatch performed out of bid sequence. On this issue the ISO does not agree with WPTF and Enron that complying with the Tariff means that it can never Dispatch Generation out of bid sequence.

The ISO has recognized and taken steps to address the concerns which WPTF and Enron describe. Indeed, the ISO commissioned the PriceWaterhouseCoopers study that WPTF and Enron cite as indicating that the ISO's procedure for Dispatching Generation out of bid sequence is insufficiently transparent (*see id.* at 7). Most significantly, the ISO plans to implement an

28 *Cf., e.g., California Independent System Operator Corporation*, 90 FERC ¶ 61,006 (2000).

automated Dispatching system in August 2000 that should provide better transparency.[29] This software will minimize the need to Dispatch Generation out of bid sequence.

In their initial brief, WPTF and Enron seem to dismiss the very concept of out-of-sequence Dispatch. They do not mention that the Commission has authorized the Dispatch of Generation out of sequence. *See* May 1999 Order, 87 FERC at 61,815 (discussing "the need to dispatch out-of-merit order"). Nor do WPTF and Enron acknowledge that the ISO is going to undertake the improvements described above. Further, although WPTF and Enron cite the PriceWaterhouseCoopers study, they ignore the study's conclusions as to why out-of-sequence Dispatch must sometimes be conducted: Intra-Zonal and Inter-Zonal Congestion, Generating Unit availability, Ramping constraints, the need to maintain Operating Reserves, the timing of intertie Dispatch, and various other grid operating conditions. *See* Joint Initial Brief of WPTF and Enron on Issues A.6, B.5.f, E.5, L.1, and L.8, Appendix at p. 109.

WPTF and Enron's proposed remedy is similarly myopic. WPTF and Enron would disallow the use of out-of-sequence Dispatch entirely. However, they neglect to mention that the PriceWaterhouseCoopers study recommends *only* that information regarding the causes of out-of-sequence Dispatch should be shared with Market Participants (after a delay sufficient to prevent confidential information from being compromised), thus providing more transparency to the market. The study does not recommend elimination of such Dispatch.

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[29] The Commission authorized the future creation and use of software that reduces the need to Dispatch Generation out of bid sequence in the May 1999 Order, 87 FERC at 61,815.

Moreover, the study recognizes – as WPTF and Enron do not – that the "need for additional transparency must be balanced against the possible deleterious effects on system stability and necessary regulation should generators use [market information] to aggressively move off schedule in the pursuit of favorable prices." *Id.* If out-of-sequence Dispatch were eliminated, such problems could well arise.

In light of the ISO's ongoing efforts to address the concerns identified by the PriceWaterhouseCoopers report, and of WPTF and Enron's overly dismissive view of Generation Dispatched out of bid sequence, WPTF and Enron's request to eliminate out-of-sequence Dispatch entirely should be denied.