UNITED STATES OF AMERICA
Before the
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation) Docket No. EL13-21-000

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO PROTEST OF J.P. MORGAN

J.P. Morgan[1] seeks to use an alleged contractual consent right to exercise anti-competitive control over resources needed to avoid the risk of blackouts for thousands of homes and businesses, as well as critical public infrastructure, in Southern California. It is undisputed that these resources – synchronous condensers – would avoid reliance on a wide-scale load-shedding scheme in Southern California during the summer of 2013. J.P. Morgan's Protest in this docket[2] obscures the material issues, seeking to delay a final order on the straightforward contractual issue presented.

While much of what J.P. Morgan presents is a mischaracterization of the reliability issues at stake, the actual legal issue for the Commission to decide is a narrow one – whether J.P. Morgan in fact has a contractual right to consent. J.P. Morgan's Protest confirms that (1) the contractual provision it relies on to exercise anti-competitive control does not give it any such right; (2) this contractual provision is explicitly linked to the Tolling Agreement, and is, therefore, jurisdictional; and (3) the Commission has, and should exercise, primary jurisdiction over this matter.

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[1] J.P. Morgan Ventures Energy Corporation and its subsidiary BE CA LLC are collectively referred to herein as "J.P. Morgan."

[2] Protest and Motion to Intervene of J.P. Morgan Ventures Energy Corporation and BE CA LLC, Docket No. EL13-21-000 (Dec. 10, 2012) ("J.P. Morgan Protest").

The ISO requests the Commission permit this Answer to J.P. Morgan's Protest because it will assist the Commission's development of a complete decisional record.

I. EXECUTIVE SUMMARY

The only decisional issue presented in the ISO's Petition is whether J.P. Morgan has a contractual right to consent to the conversion of Huntington Beach Units 3 and 4 ("HB 3 and 4") to synchronous condensers. J.P. Morgan has asserted this right, seeking to block the project, based upon a provision in one of two inextricably linked documents, a Tolling Agreement[3] and a supplemental set of terms related to that agreement (the "Supplemental Agreement"),[4] which together constitute the complete terms of one jurisdictional contract. J.P. Morgan concedes that the Tolling Agreement provides no basis for its alleged consent rights. The ISO has shown that the consent provision in the Supplemental Agreement is, by its own terms inapplicable, as it applies only to "Capacity." It is undisputed that the synchronous condensers do not add Capacity as that term is defined by the agreements. Attempting to avoid this dispositive fact, J.P. Morgan is reduced to asserting that the term "Capacity" must mean something other than what the parties expressly defined it to mean in the agreement, which is "the *MW* output level that a *generating unit* is capable of continuously producing."[5]

In an effort to distract the Commission from this straightforward issue, J.P. Morgan presents a host of side issues, each without merit.

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[3] Capacity Sale and Tolling Agreement, May 1, 1998, Docket No. ER98-2184, et al. ("Tolling Agreement"). The Tolling Agreement was also filed as Appendix D to the ISO's Petition for Declaratory Order and Expedited Treatment (Nov. 15, 2012) ("ISO Petition").

[4] Supplemental Agreement, May 1, 1998 (unfiled) ("Supplemental Agreement"). J.P. Morgan refers to this second linked document as the "Development Agreement." The Supplemental Agreement was filed as Appendix D to the ISO's Petition.

[5] Tolling Agreement at section 1.17, ISO Petition at 95.

First, J.P. Morgan's contention that the Commission lacks jurisdiction is belied by the Commission's earlier final orders finding the very contract involved in this proceeding to be jurisdictional, as well as by the subject matter encompassed by the agreement. As J.P. Morgan's own arguments demonstrate, there is only one agreement, which consists of two intertwined documents. In an effort to avoid this fact, J.P. Morgan tries to isolate the Supplemental Agreement and claim it is a separate non-jurisdictional contract. The Supplemental Agreement, however, on its face is not a stand-alone agreement and it cannot be divorced from the Tolling Agreement. Rather, it specifically incorporates the Tolling Agreement, and, again as J.P. Morgan admits, is a significant part of the bargained for consideration between the parties. In the words of the Supplemental Agreement, the two documents together constitute "the entirety of the agreements between the parties."[6]

When it first evaluated the Tolling Agreement, the Commission concluded that it was jurisdictional because it was an agreement in connection with the rates and terms and conditions of service. As a result, the Commission required the whole agreement to be filed and available for review. J.P. Morgan's attempt to sever the two parts of the agreement to prevent what it views as a competitive alternative to its generation services demonstrates why the Commission ordered the entire agreement between the parties to be available for review and why the Commission requires disclosure by the holder of market-based rate authority of the facilities over which it exercises control.

Moreover, J.P. Morgan confuses technical concepts that are within the Commission's special expertise and illustrate why the Commission's exercise of primary

[6] Supplemental Agreement at section 6.1, ISO Petition at 230.

jurisdiction is warranted. The Commission's expertise is necessary to see through the inconsistencies and inaccuracies that permeate J.P. Morgan's Protest on highly technical subjects, including, for example, questions of what constitutes capacity, ancillary services, and the generation of MWs, rather than voltage support, MVARs and reactive power.

J.P. Morgan also attempts to manufacture a factual dispute as to the reliability need for the synchronous condensers. While the reliability need is a pertinent background fact to tell the full story as to how the ISO came to designate HB 3 and 4 to provide reliability services, it has no bearing on the narrow legal question presented to the Commission in this docket: whether J.P. Morgan has a contractual consent right, and thus the ability to block the synchronous condenser project.

In any event, J.P. Morgan presents nothing more than speculation and misleading and incomplete facts. The ISO, under its Commission-approved tariff authority and its obligations under the North American Electricity Reliability Corp. ("NERC") Mandatory Reliability Standards, examined the potential alternatives and none were feasible, including maintaining HB 3 and 4 as generators for the summer of 2013. The legally deficient conjecture offered by J.P. Morgan's affiant about the possible return of HB 3 and 4 to service as generators is demonstrably incorrect.

Moreover, as the ISO informed J.P. Morgan, the ISO was willing to accept the continued operation of HB 3 and 4 as generating units, if that could have been accomplished. But, J.P. Morgan's proposal to transfer air permits was then, as it is now, infeasible. Indeed, the ISO told J.P. Morgan that if J.P. Morgan could transfer air permits, as it had suggested, then the ISO would be very interested in maintaining HB 3

and 4 as generating units. However, the ISO insisted that due to the severe time constraints, any effort to obtain the air permits needed to support the continued operation of HB 3 and 4 as generators would need to proceed on a parallel path with the reliability must-run agreement supporting the construction of the synchronous condensers, because the ISO was working against the clock. If J.P. Morgan had been successful in obtaining air permits allowing B3 and 4 to continue to operate as generators, and had the generation alternative been secured in a timeframe that protected Southern California, the ISO would have abandoned the effort to construct the synchronous condensers. The proposal is not a viable option, as the comments of the Air Resources Board filed in this proceeding make clear.

J.P. Morgan does not dispute that, without the synchronous condensers, or generating units at HB 3 and 4, the ISO will need to employ a load shedding plan for the summer 2013 to address certain contingencies. In fact, it is undisputed that the synchronous condensers avoid the need to rely upon an 800 MW load shedding scheme for San Diego and, together with other voltage support measures, avoid the need to rely upon an additional load shedding scheme of up to 2200 MW in Southern Orange County.[7] J.P. Morgan, however, seeks to minimize the reliability risk by claiming that the load shedding plan for San Diego is no different from certain past load shedding plans. This claim is incorrect and relies upon a misunderstanding or mischaracterization of the prior plans, and understates the serious fire risk that threatens the facilities at issue. Indeed, J.P. Morgan's claim that the probability of simultaneous outages is actually near

[7] Sparks November 15 Decl. at PP 24, 29.

"once in almost a millennium" is a gross understatement, which inappropriately relies on N-2 outage data to analyze the more likely occurrence of an N-1-1 contingency.

The facts about which there can be no dispute are that:

- The people of Southern California are confronted with a genuine and substantial risk of outages that can be avoided by the synchronous condenser project;
- J.P. Morgan's cavalier willingness to place those people at risk to preserve its mistaken perception of an entitlement to block the project and preserve a share of the market is unacceptable;
- Under its tariff, the ISO is responsible for making the decision to designate generating units needed for reliability services; and
- The ISO's decision was an appropriate decision.

Finally, J.P. Morgan's claim that the ISO is attempting to have the Commission force J.P. Morgan to consent is mere rhetoric. The ISO requested the Commission to review the contract and confirm as a matter of law that J.P. Morgan had no such consent right or, if it found that there was a consent right, to modify the contract because of the compelling public need. The ISO seeks only to compel J.P. Morgan to stop interfering with the effort to provide reliable service to Southern California.

II. The Tolling Agreement and the Supplemental Agreement are Inextricably Linked as Jurisdictional Agreements.

J.P. Morgan attempts to evade the Commission's jurisdiction by disclaiming any right to consent under the Tolling Agreement and arguing that its consent rights flow from a purportedly distinct "private commercial agreement"[8] between the parties – the Supplemental Agreement – that J.P. Morgan claims is non-jurisdictional. J.P. Morgan has no consent right under the Tolling Agreement. J.P. Morgan cannot, however, evade

[8] J.P. Morgan Protest at 15.

the Commission's jurisdiction by attempting to sever the Supplemental Agreement from the jurisdictional contract.

Although rendered on separate paper and never filed with the Commission, the Supplemental Agreement is not actually a legally separate agreement from the Tolling Agreement. Rather, the Supplemental Agreement is merely a set of additional terms and conditions ***for the same transaction***. The Supplemental Agreement cannot be given meaning without relying on the Tolling Agreement. Taken together, the two comprise the single basis of the contractual relationship between the parties and that contract is FERC jurisdictional.

There can be no serious debate that the Supplemental Agreement and the Tolling Agreement are effectively two parts of one whole, nor does J.P. Morgan offer any basis to conclude otherwise. Both documents were entered into by the same parties on the same day, and the Supplemental Agreement expressly provides that its term begins on the effective date of the Tolling Agreement and "automatically" terminates upon termination of the Tolling Agreement.[9] The Supplemental Agreement also incorporates by reference all of the definitions used in the Tolling Agreement,[10] expressly incorporates by reference numerous Tolling Agreement provisions,[11] and contains an integration clause that expressly stitches the two documents together by providing that:

> "This Agreement, including all Exhibits hereto, ***together with the Tolling Agreement constitutes the entire agreement between the Parties hereto*** with respect to the matters contained herein and therein . . . ."[12]

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[9] Supplemental Agreement at section 1.1, ISO Petition at 222.

[10] *Id.* at p. 1, ISO Petition at 222.

[11] *Id.* at section 6.2, ISO Petition at 229.

[12] *Id.* at section 6.1 (emphasis added), ISO Petition at 229.

The documents also cover the same fundamental subject matter – the rates, terms, and conditions under which the purchaser (now J.P. Morgan) would agree to pay AES for the rights to control AES's facilities and conduct. Some of those terms were included in the Tolling Agreement. But as J.P. Morgan acknowledges, the consent rights in the Supplemental Agreement were a key component of this deal because development of new generation "could affect the revenues and other economic benefits bargained for by AES and JPMVEC under the Tolling Agreement."[13] Put another way, J.P. Morgan has conceded that the consent rights in the Supplemental Agreement were part of the overall benefit of the bargain, the rest of which was embodied in the Tolling Agreement. Given this nexus, it is spurious to suggest that the Supplemental Agreement is a somehow a distinct "private commercial agreement"[14] simply because it is written on separate paper, and to then claim that this allows J.P. Morgan to evade the Commission's jurisdiction.

This attempted separation is contrary to New York contract law, which the parties agreed applies to the construction and interpretation of both documents.[15] Under New York law, courts have considered that "[g]enerally, separate writings are construed as one agreement if they relate to the same subject matter and are executed simultaneously."[16] This is exactly the situation here.

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[13] J.P. Morgan Protest at 8.

[14] *Id.* at 15.

[15] Tolling Agreement at section 23.10, ISO Petition at 50. The Supplemental Agreement expressly incorporates this provision by reference. *See* Supplemental Agreement at section 6.2, ISO Petition at 229.

[16] *Commander Oil Corp. v. Pass & Seymour, Inc.*, 991 F.2d 49, 53 (2d Cir. 1993) (citing *Carvel Corp. v. Diversified Mgmt. Group, Inc*., 930 F.2d 228, 233 (2d Cir. 1991); *Rudman v. Cowles Communications, Inc.*, 30 N.Y.2d 1, 13 (1972); *Nau v. Vulcan Rail & Constr. Co.*, 36 N.E.2d 106, 110 (1941). *See also* ISO Petition at 31 (further discussing New York law on this issue).

Indeed, the Federal Power Act and the Commission's own precedents recognize that Commission jurisdiction applies in such contexts. Section 205(c) of the Federal Power Act requires public utilities to file:

> "schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, *together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services*."[17]

As the Commission explained in its *Prior Notice Order* proceedings, the scope of the "affect or relate" language in Section 205(c) is "quite broad."[18] Under this provision, "the question of [the Commission's] jurisdiction over a particular contract depends on whether the contract contains a rate or charge for or in connection with the transmission or sale of electric energy in interstate commerce, *or whether the contract affects or relates to such rates or services.*"[19]

Here, there is no question that the "consent provision" in the Supplemental Agreement affects or relates to the rates or services at issue in the Tolling Agreement. Indeed, J.P. Morgan admits this provision was a critical component of the benefit of the bargain that was necessary to ensure that its economic interests in the Tolling Agreement were protected.[20] This relationship, together with the other indicia discussed above demonstrating that the two documents are one agreement, render the consent provisions of the Supplemental Agreement subject to the Commission's jurisdiction.

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[17] 16 U.S.C. § 824d(c) (2012) (emphasis added).

[18] *Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, Order on Rehearing, 65 FERC ¶61,081 at 61,508 (1993) ("Prior Notice Rehearing Order").

[19] *Prior Notice and Filing Requirements Under Part II of the Federal Power Act*, Final Order, 64 FERC ¶61,139 at 61,990 (1993) ("Prior Notice Order") (emphasis added).

[20] J.P. Morgan Protest at 8.

Treating the consent provisions as non-jurisdictional also would be fundamentally at odds with the Commission orders directing the parties to file the entire Tolling Agreement and approving its transfer to J.P. Morgan.[21] Both orders were predicated on the Commission's continuing need to ensure that the purchasing party (now J.P. Morgan) does not exercise undue market power. If a party could thwart the Commission's jurisdiction over a provision that can interfere with competing developments by not disclosing it and writing it on a separate piece of paper, the Commission's ability to ensure just and reasonable rates would be frustrated.

J.P. Morgan seeks to avoid this outcome by likening the Supplemental Agreement to a "construction agreement" and relying upon precedents holding that such agreements are not jurisdictional in certain contexts. But this analogy is misplaced because the consent provision is not in any way similar to a construction agreement. The consent provision does not establish the terms under which two parties will engage in the development or construction of facilities, but rather does the opposite. It erects a consent-based condition that in certain contexts (though not here) *prevents* a party from developing a project that may potentially compete with the output of the facilities controlled by J.P. Morgan. By misapplying the "construction" agreement precedents to this completely different context, J.P. Morgan asks the Commission to disclaim jurisdiction over provisions that fundamentally affect or relate to rates, terms, and conditions in connection with the transmission or sale of wholesale power and which provide J.P. Morgan with the ability to veto actions by AES.

[21] *See* ISO Petition at 20-22.

Finally, even if the Commission found that the Supplemental Agreement need not have been filed when executed, it still has jurisdiction to interpret the Supplemental Agreement now. The Commission has discretion to forego requiring an entity to file an agreement in certain circumstances, but even where the Commission exercises this discretion it still retains jurisdiction to review an agreement that "affects or relates to" any jurisdictional service provided by a public utility, as the Supplemental Agreement does here.[22]

III. J.P. Morgan's Protest Demonstrates Why the Commission Should Exercise its Primary Jurisdiction.

The ISO has shown that this proceeding is distinctly well-suited for the exercise of the Commission's primary jurisdiction under each of the three *Arkla* criteria.[23] J.P. Morgan offers only perfunctory arguments to the contrary that are belied by the rest of its pleading.

J.P. Morgan first asserts that no Commission expertise is required here because the consent provision of the Supplemental Agreement "is a garden variety commercial provision that raises none of the technical or industry-specific features that might implicate the Commission's expertise."[24] But three pages later J.P. Morgan proceeds to make a series of arguments about the meaning of the term "Capacity" in that provision

[22] *See PacifiCorp*, 127 FERC ¶ 61,144 (2009); *Public Service Company of Colorado*, 67 FERC ¶ 61,371, 62,267 (1994). *See also Prior Notice Rehearing Order*, 65 FERC at 61,508 (applying rule of reason to excuse entity from filing transmission study contracts, but holding that the contracts are nonetheless subject to the Commission's jurisdiction and review in a complaint case because they "'affect or relate to' jurisdictional service).

[23] *See* ISO Petition at 17-20. The Commission applies a three-part test to determine whether it will exercise primary jurisdiction in any matter, in which it considers: (1) whether the Commission possesses some special expertise which makes the case peculiarly appropriate for Commission decision; (2) whether there is a need for uniformity of interpretation of the type of question raised by the dispute; and, (3) whether the case is important in relation to the regulatory responsibilities of the Commission. *Arkansas Louisiana Gas Co. v. Hall,* 7 FERC ¶ 61,175, *reh'g denied,* 8 FERC ¶ 61,009 (1979) ("Arkla").

[24] J.P. Morgan Protest at 26.

that relies upon the meaning of "Ancillary Services," discusses the meaning of VARs, and attempts to draw upon the meaning of other provisions in the ISO's tariff purportedly as support for J.P. Morgan's interpretation.[25] While these arguments, as discussed further below, are all specious, they do illustrate that resolving the legal arguments at issue here requires the Commission's special expertise. The Commission is much better suited than a court would be to evaluate J.P. Morgan's claims about the meaning of technical terms and the ISO's tariff.

J.P. Morgan seeks to address the second criterion – the "need for uniformity" – in one sentence, simply asserting that this criterion is not met because the Supplemental Agreement involves "one-off language, making the case entirely fact bound."[26] This of course cannot be reconciled with J.P. Morgan's contradictory claim several pages earlier that the contract is a "commonplace private commercial agreement" that is similar to other types of construction arrangements.[27] In any event, the argument misunderstands the nature of the *Arkla* uniformity requirement. As discussed in the ISO's Petition, the uniformity criterion considers whether the contract interpretation affects others beyond the two parties involved.[28] J.P. Morgan is advancing a contract interpretation that, if adopted, would negatively affect the ISO's ability to reliably meet peak power demand in Southern California and would undermine the Commission's ability to ensure reliability and protect against potential market power. These interests demonstrate the broader

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[25] *See* J.P. Morgan Protest at 29-31.

[26] *Id.* at 27.

[27] *Id.* at 15-17.

[28] ISO Petition at 18 (and cases cited therein).

public interests implicated by J.P. Morgan's interpretation of its contract and the need for the Commission to assert primary jurisdiction.

For the same reasons, the third *Arkla* criterion – whether the case is important in relation to the Commission's regulatory responsibilities – also is met here. J.P. Morgan offers no meaningful argument on this point. It acknowledges the ISO's concerns regarding the reliability impact underlying this dispute, but asserts that "the substance of the issue CAISO asks the Commission to address has nothing to do with the Commission's regulatory responsibilities."[29] This assertion ignores the Commission's fundamental role in ensuring that jurisdictional agreements are just and reasonable and in protecting wholesale markets from the impermissible exercise of market power.

Finally, it bears mention that J.P. Morgan's arguments on jurisdiction and primary jurisdiction proceed from an incorrect premise: that the ISO is fundamentally asking the Commission to "abrogate" or "modify" the terms of its agreement with AES. This is simply not correct. The ISO's Petition makes clear that, first and foremost, it is asking the Commission to declare the meaning of the agreements as they are written. The possibility of modification would come into play only if there were a provision that could somehow be interpreted to provide a consent right involving the synchronous condenser project. Because there is no such provision – as shown in the ISO's Petition and discussed further below – J.P. Morgan's assertions regarding the limits of the Commission's authority to modify an agreement are entirely beside the point.

[29] J.P. Morgan Protest at 28.

IV J.P. Morgan's Protest Demonstrates That It Lacks Any Contractual Right to Consent to the Synchronous Condenser Project.

J.P. Morgan's Protest goes on for 28 pages before addressing the basic legal question at issue in the Petition – whether J.P. Morgan actually holds a contractual right of consent with respect to the synchronous condensers at issue here. J.P. Morgan deflects attention away from this key question because it has no viable argument to make. As noted above, J.P. Morgan concedes that the Tolling Agreement is not the source of any such entitlement.[30] It instead relies on Section 2.1 of the Supplemental Agreement, which no amount of legal gymnastics can convert into a consent right for the construction of synchronous condensers.

J.P. Morgan acknowledges, as it must, that Section 2.1 by its express terms provides a consent right only for an addition of "Capacity." The Supplemental Agreement, as J.P. Morgan correctly notes, incorporates the definition of "Capacity" in the Tolling Agreement,[31] which defines the term as follows:

> "*Capacity* or *capacity* means the MW output level that a generating unit is capable of continuously producing."

This definition is the end of the matter here. It is undisputed that the resource that AES is seeking to develop here is a synchronous condenser – not a generating unit – that does not produce any megawatts and instead produces only megavars.[32] Thus, the provision by its express terms is inapplicable here.

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[30] *See* J.P. Morgan Protest at 14 ("[t]he Tolling Agreement is superfluous here because JPMVEC does not rely on that Agreement for its consent rights.").

[31] Supplemental Agreement at p. 1, ISO Petition at 222 ("all capitalized terms used in this Agreement that are not defined herein have the meanings given in the Tolling Agreement).

[32] The Tolling Agreement defines MW as follows: "MW means megawatt." Tolling Agreement at section 1.74, ISO Petition at 111.

J.P. Morgan seeks to avoid this outcome by arguing that "Capacity" is really the same thing as ancillary services and that the Tolling Agreement's definition of "Ancillary Services" is broad enough to cover megavars.[33] But the definition of "Ancillary Services" in the Tolling Agreement is completely beside the point because Section 2.1 does not give J.P. Morgan a consent right for "Ancillary Services." The provision uses the term "Capacity," and the Tolling Agreement defines the two terms differently. Indeed, the existence of separate definitions for "Capacity" and "Ancillary Services" eviscerates the very argument that J.P. Morgan is trying to make. If the parties had intended "Ancillary Services" and "Capacity" to be synonymous, there would have been no reason for two separate definitions. The parties specifically used the more narrowly defined term "Capacity" in the consent provision and thereby limited the consent right to the construction of generating facilities that produce megawatts. There is no basis for expanding the consent right to include an entitlement that J.P. Morgan's contractual predecessor did not bargain for or receive.

J.P. Morgan's only other argument is that the narrow definition of "Capacity" in the Tolling Agreement is somehow inconsistent with definitions employed in the ISO's tariff. This argument is equally off point because the ISO tariff has nothing to do with the meaning of a term that is expressly defined in the Tolling Agreement. If the parties had intended to rely upon the ISO's tariff for the definition of "Capacity" they would have said so in their agreements. Having established its own independent definition in the Tolling Agreement, J.P. Morgan cannot rely upon the ISO tariff or any other source for an alternative definition.

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[33] J.P. Morgan Protest at 30.

In sum, J.P. Morgan has no contractual basis for asserting that the synchronous condenser installation project requires its consent. The ISO respectfully requests that the Commission address this issue expeditiously, so that the parties can move forward in time to address the reliability concerns that are motivating this project in time for peak demand next summer.

V. J.P. Morgan's Attempt to Minimize the Serious Reliability Issue Facing Southern California is Misleading and Fails to Create a Material Factual Dispute.

J.P. Morgan does not contest that there is a serious reliability issue that the ISO is attempting to resolve. Rather, it attempts to undercut the rationale supporting the only feasible solution the ISO has identified – the conversion of HB 3 & 4 to synchronous condensers. J.P. Morgan's assertions are not material for purposes of the legal determination the ISO has requested that the Commission make in this proceeding: whether J.P. Morgan has a contractual right to consent, or withhold consent, allowing it to exercise control and block this project.

Even so, J.P. Morgan's arguments, and "expert" declarations are based upon vague assertions, misleading statements, and mischaracterizations that wither under any scrutiny and fail to support J.P. Morgan's claims. J.P. Morgan's arguments are founded on three faulty premises:

> (i) It has offered a better solution to the reliability problem than the synchronous condenser project, i.e. to return HB 3 and 4 to service as generators;
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> (ii) HB 3 and 4 may still be returned to service as generators; and
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> (iii) The reliability problem that the ISO is attempting to resolve is not so serious after all—that there are other load-shedding plans that are currently in force in California of a roughly similar magnitude and load-shedding in Southern California it is not all that likely, after all.

Each of these contentions is unsupported, demonstrably wrong, and, in any event not material to the legal question presented to the Commission in this docket. This proceeding does not encompass the ISO's reliability need determination, its designation of HB 3 and 4 as RMR units or whether the units should be converted to synchronous condensers under the RMR contract in response to the SONGS outage. Rather, this proceeding is about the whether the contract J.P. Morgan seeks to use to block the conversion of HB 3 and 4 into synchronous condensers, and thus interfering with the ISO's reliability based determinations, actually gives it the right to do so.

A. The Proposal to Return HB 3 and 4 to Service As Generators Is Not Feasible.

While J.P. Morgan may assert, incorrectly, that there are better alternatives to meet the reliability needs in Southern California, this fails to recognize that it is the ISO (not J.P. Morgan) that has the authority and the obligation to make this determination based upon its technical studies. Indeed, under FPA section 205, the Commission limits its inquiry into whether the proposed rates terms and conditions are reasonable and not whether the proposal is more or less reasonable than alternative proposals.[34] Similarly, an independent system operator's determination of reliability need is also evaluated by the Commission pursuant to section 205.[35] In other words, J.P. Morgan's arguments concerning the reliability need and how it is met would be rejected even if they were raised in the appropriate docket.

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[34] *City of Bethany v. FERC*, 727 F.2d 1131, 1136 (D.C. Cir. 1984).

[35] *See, e.g.*, *Pittsfield Generating Co, LP*, 114 FERC ¶ 61,059, PP 28-31 (2005) (the Commission upheld the ISO New England's determination of reliability need – voltage support – and its determination that a specific resource was needed to provide the service under an RMR agreement).

In any event, as Mr. Sparks explained in his November 15 declaration,[36] the ISO, in consultation with SCE and SDG&E, considered other options before determining that conversion of the generating units into synchronous condensers was the only feasible option for obtaining voltage support within the timeframe in which the reliability need must be met.

As J.P. Morgan knows, one of the options the ISO considered was J.P. Morgan's proposal to retain HB 3 and 4 as generators rather than to convert them into synchronous condensers. Had that approach been feasible, it would have been acceptable to the ISO from the standpoint of the reliability need. Indeed, the ISO advised J.P. Morgan that this was a potentially acceptable option if J.P. Morgan could address the air permit issues, but also advised J.P. Morgan that the ISO would have to pursue the synchronous condenser project on a parallel path due to the time constraints associated with project. J.P. Morgan did not respond to this invitation.

It is highly unlikely that, even if it had tried, J.P. Morgan could have obtained the air permits that would have been needed in the timeframe necessary to run the plants next summer, given the regulatory hurdles. J.P. Morgan never sought the authority from the South Coast Air Quality Management District that would have been necessary to transfer air permits from one plant to another. In short, J.P. Morgan had no ability to carry out its HB 3 and 4 proposal when it advanced it. Today, as noted by the California Air Resources Board (below), HB 3 and 4 have ceased operating as generating units; the

[36] *See* Sparks November 15 Declaration, filed as Appendix A of ISO Petition at P 14 ("Sparks Nov. 15 Declaration").

units have surrendered their air permits, and have been rendered inoperable at the direction of the South Coast Air Quality Management District.[37]

Nor does the legally deficient speculation offered by the J.P. Morgan affiant about whether HB Units 3 and 4 might still be able to be returned to service as generators provide the basis of a factual dispute. Mr. Onufer is plainly mistaken – as a matter of law – about the surmise and conjecture that he recites under oath.

The filing of the California Air Resources Board in this proceeding makes it clear that:

> Huntington Beach Units 3 and 4 will be unable to generate electricity to meet demand in 2013 and beyond. Extensive steps have already been undertaken to physically disable the steam generators. The air permit has been surrendered to SCAQMD, and Walnut Creek Energy Park has commenced commissioning activities using the emission reductions from the shut down of Units 3and 4. Any future operation of these boilers to generate electricity would require a new construction permit and new offsets, which are costly and in limited supply in the SCAQMD. Given the timing for a new permitting action, the significant challenges with obtaining new offsets, and the steps already taken to disable the steam generators, it is not possible that Units 3 and 4 would be available to meet reliability needs as generators next summer.

California Air Resources Board Letter, Docket Nos. ER13-351, EL13-21 (Nov. 30, 2012).

To address the Air Resources Board point that offsets would be required before any new permit could be issued to HB 3 and 4, Mr. Onufer speculates that emission credits could be transferred to HB 3 and 4 from unidentified sources purportedly offered by J.P. Morgan. To support his speculation, Mr. Onufer notes that credits from HB 3 and 4 were transferred to Walnut Creek Generating Station, and relays a South Coast Air

[37] California Air Resources Board Letter, Docket Nos. ER13-351, EL13-21 (Nov. 30, 2012).

Quality Management District statement that future shutdown of HB 1 and 2 will provide offsets for new generation at Huntington Beach. However, Mr. Onufer cites to no rule that would allow the transfer of the unidentified credits to HB 3 and 4 in the same manner as the other transfers he describes. Indeed, there is none. The other transfers have proceeded and will proceed under South Coast Air Quality Management District Rule 1304(a)(2), which applies only where existing steam boilers are being replaced by newer combined cycle or other more advanced technology. Older steam boilers such as HB 3 and 4 can only be the "donor," not the "recipient," of emission credits under the Rule. Without access to the transfers of credits through Rule 1304(a)(2), completion of the new source review permit process and acquisition of a new air permit for HB 3 and 4 would be stymied by the chronic shortage of emission reduction credits in region.

Mr. Onufer also suggests that the prior air permit for HB 3 and 4 could be reinstated by the South Coast Air Quality Management District. However, he refers to a rule that does not apply to the current circumstances. Rule 301(g) allows reinstatement of a permit when the permit has expired due to non-payment of fees and within one year the overdue fees and surcharge are paid. But the HB 3 and 4 permits cannot be reinstated under Rule 301. They did not lapse because of non-payment of fees; they were surrendered as part of the permitting of Walnut Creek Energy Park. Moreover, any emissions reductions confirmed through the surrender of the permits no longer reside in any South Coast Air Quality Management District internal bank – they passed out of the internal bank when Walnut Creek commenced operations.

The notion that a variance could have been obtained misperceives the multiple layers of environmental regulations that govern generation in California. A variance

protects the emitter only from enforcement under California law, and even if it had been obtained it would have left Edison Mission Energy (who acquired the generators at HB 3 and 4) vulnerable to enforcement by Environmental Protection Agency or citizen suit under the federal Clean Air Act.[38] Although the South Coast Air Quality Management District rules provide another, similar process for obtaining relief from federal enforcement, this mechanism is not available where a facility lacks an air permit.[39] Moreover, even if a variance from State enforcement were obtained, its benefits would be short-lived and inadequate to address the 2013 reliability needs. District Rule 504(e) provides that no variance may allow emissions to exceed an applicable Regulation XIII offset threshold for more than 90 days. Regulation XIII is the nonattainment New Source Review program, which would require HB 3 and 4 to obtain offsets in order to operate, even through the variance route.

In short, the ISO carefully considered resurrecting HB 3 and 4 as generators to meet the summer 2013 reliability needs, and determined it simply had too little chance of being accomplished within the timeframe needed.

B. J.P. Morgan's Claims About Other Load-Shedding Schemes are Erroneous.

J.P. Morgan asserts, essentially, that the ISO, and the people of Southern California, should simply accept the risk of wide-spread load shedding, rather than support and develop the synchronous condenser project, based upon the existence of other different load shedding schemes. Not only is this argument misplaced, as it is immaterial to the discrete legal question at issue here, but it is erroneous. Indeed, the ISO

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[38] 42 U.S.C. § 7604 (2012).

[39] District Rule 518.2(c)(2)(A) (2001).

is seeking to avoid reliance on a wide-spread load shedding scheme, and J.P. Morgan's arguments merely underscore the need for a Commission decision.[40]

J.P. Morgan does not dispute that without synchronous condensers or generating units at HB 3 and 4, the ISO must employ a load shedding scheme for the summer of 2013 to address certain under-voltage contingency scenarios, as described by Mr. Sparks. Instead, J.P. Morgan seeks to minimize the significance of relying on such a load shedding scheme by asserting that it is not "unprecedented," and is essentially the same as load shedding schemes that the ISO has relied upon in other circumstances. This is incorrect. J.P. Morgan identifies three load shedding schemes, associated with Path 15, Path 26, and the Santiago substation, which involve scenarios fundamentally different, and less likely to occur than the circumstances the ISO presently confronts.

As Mr. Sparks explained, the load shedding scheme required without the synchronous condensers at HB 3 and 4 would result in load being shed when a particular N-1-1 contingency occurs, in which one major transmission element first fails, and is then followed by the loss of another major transmission element before restoration of the first element can be achieved.[41] The Path 15 and Path 26 load shedding schemes, however, are designed to respond to an N-2 contingency in which two major transmission elements simultaneously fail. Under NERC's transmission planning standards, the N-2 contingencies for Paths 15 and 26 are each classified as a Category D contingency, while

[40] As the Commission has stated in various contexts, "load shedding is the option of last resort." *See, e.g.*, *Mandatory Reliability Standards for the Bulk-Power System*, Order No. 693 at P 550, FERC Stats. & Regs.¶ 31,242 (2007), 72 Fed. Reg. 16,416 (Apr. 4, 2007), 72 Fed. Reg. 31,452 (June 7, 2007); *order on reh'g*, Order No. 693-A, 120 FERC ¶ 61,053 (2007).

[41] Sparks November 15 Declaration at PP 9-11 (Nov. 15, 2012).

the N-1-1 contingency that the ISO is seeking to avoid with synchronous condensers is classified as a Category C contingency**.**[42]

This distinction is important because the classification scheme is based upon the risk that a particular contingency will come to pass. NERC considers a Category D contingency to be less likely to occur than a Category C contingency, and the measures that must be taken as a matter of transmission planning to avoid the contingency are less stringent.[43]

Mr. Mackin also refers to a load shedding scheme associated with the Santiago substation. There was a load shedding scheme in place at this facility during 2009-2011, to respond to a contingency in which the loss of a generating element is rapidly followed by the loss of two major transmission elements. This is a G-1/N-2 scenario which also is a Category D contingency, more remote than the N-1-1 scenario at issue here. [44] As for the special protection scheme not put into place until 2012,[45] Mr. Mackin is apparently referring to a protection scheme employed on a temporary, emergency basis after SONGS units unexpectedly went out of service in early 2012. Establishing this back-up protection scheme on an emergency basis is prudent practice, and far different from relying upon a load shedding scheme, as part of the ISO's transmission planning

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[42] *See* Declaration of Robert Sparks submitted herewith as Attachment A at PP 5-7 ("Sparks December 17 Decl.").

[43] Mr. Mackin states that Path 15 and Path 26 protection schemes are designed to address outages that fall into "NERC/WECC Category 'C-5'". Affidavit of R. Peter Mackin at PP 13-14, Docket No. ER13-21-000 (Dec. 10, 2012) ("Mackin Affidavit"). This creates the misimpression that NERC has categorized such N-2 outages as Category C. In fact, NERC has classified these contingencies as Category D. While there is a separate WECC criterion that requires entities in the WECC area to treat certain NERC-classified Category D contingencies as though they were in Category C, this does not change the fundamental fact that these are N-2 contingencies that NERC has determined are inherently less likely to occur than the N-1-1 contingency at issue here. Sparks December 17 Decl. at P 8.

[44] Sparks December 17 Decl. at P 9.

[45] Mackin Affidavit at P 16.

scenario, that is entirely avoidable through other measures, such as deployment of the synchronous condensers.[46]

J.P. Morgan's cavalier disregard of the risks to the people of Southern California is further illustrated by its mischaracterization of the fire risk data provided in Mr. Sparks' declaration. The contingency risks to which J.P. Morgan refers in the SDG&E report do not relate to the N-1-1 contingency, but to a more remote N-2 contingency. The risk of that N-2 contingency is much more remote because a physical event that endangers two lines that are not on the same set of towers – such as a fire – is extremely unlikely to cause an outage of both facilities at the exact same time.[47] By applying N-2 data to an N-1-1 contingency, J.P. Morgan misrepresents the data. Its claim that the risk is "once in almost a millennium" is unfounded, and severely understates the risk of the contingency at issue without the synchronous condensers.

[46] Sparks December 17 Decl. at P 10. J.P. also Morgan mischaracterizes Mr. Sparks' testimony before the California Public Utilities Commission ("CPUC") in asserting that this testimony is somehow inconsistent with his November 15 declaration. *See* J.P. Morgan Protest at 2. In fact, his testimony is entirely consistent with his declaration in this matter, and at the CPUC Mr. Sparks testimony supports the procurement of additional resources as a means to avoid reliance on protection schemes. *See* Sparks December 17 Decl. at PP 11-12.

[47] Sparks December 17 Decl. at PP 13-15.

V. CONCLUSION

J.P. Morgan has identified only one contract provision, section 2.1 of the Supplemental Agreement, that it claims supports a consent right. But, since that section applies only to Capacity, it cannot establish the right that J.P. Morgan claims. The ISO respectfully requests that the Commission expeditiously issue a declaratory order finding that J.P. Morgan has no contract consent right to exercise in connection with the synchronous condenser project.

Respectfully submitted,

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Washington, D.C.
December 17, 2012

ATTACHMENT A

DECLARATION OF ROBERT SPARKS

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation **Petitioner** **v.** **BE CA LLC** **and** **J.P. Morgan Ventures Energy Corp.**	)))))))))))	**Docket No. EL13-21-000**

DECLARATION OF ROBERT SPARKS

1 I, Robert Sparks, do hereby declare and state:

2 **1.** My name is Robert Sparks. I am employed by the California Independent
3 System Operator Corporation as Manager, Regional Transmission. My
4 business address is 250 Outcropping Way, Folsom, California. My
5 witness qualifications were included in the declaration I originally
6 submitted in this proceeding on November 15, 2012 ("November 15
7 Declaration").

8 **A. Purpose and Summary of Declaration.**

9 **2.** This declaration responds to certain assertions made by J.P. Morgan
10 Ventures Energy Corporation (J.P. Morgan) in its December 10, 2012

1 pleading in the above-captioned proceeding ("JPM Protest") and in the
2 Peter Mackin affidavit ("Mackin Affidavit") submitted with the JPM Protest,
3 relating to my November 15 Declaration submitted in this proceeding.
4 **3.** J.P. Morgan and Mr. Mackin do not dispute that, in the absence of
5 synchronous condensers or generating units at HB 3&4, the ISO will need
6 to employ a load shedding scheme for the summer of 2013 to address
7 certain undervoltage contingency scenarios, as described in my
8 November 15 Declaration. Instead, they seek to minimize the significance
9 of the load shedding scheme from a reliability perspective by asserting
10 that this load shedding scheme is not "unprecedented," and is essentially
11 the same as load shedding schemes that the ISO has relied upon in other
12 circumstances. This assertion is erroneous. As discussed below, the load
13 shedding schemes JP Morgan identified either involved scenarios that are,
14 by definition, more remote and unlikely to occur than the scenario at issue
15 here, or involved an unavoidable emergency measure that was taken only
16 on a short-term basis to address an unanticipated outage.
17 **4.** J.P. Morgan also mischaracterizes the fire risk data provided in my
18 November 15 Declaration and the underlying risk data from the SDG&E
19 report. As discussed below, the statements in my November 15
20 Declaration regarding the frequency of fires are fully accurate and apply
21 specifically to the N-1-1 contingency at issue in this case (i.e., an N-1-1
22 loss of the Imperial-Valley-Miguel 500kV line followed by the loss of the
23 Imperial Valley-Suncrest 500 kV line). By contrast, the probability range

1 that J.P. Morgan pulls from the underlying SDG&E report relates to a
2 different and more remote N-2 contingency.

3 **B. <u>The Load Shedding Schemes Identified by J.P. Morgan</u>**

4 **5.** Mr. Mackin identifies three load shedding schemes associated with the
5 following transmission locations: Path 15, Path 26, and the Santiago
6 substation. These load shedding schemes involve scenarios that are
7 fundamentally different from the N-1-1 scenario at issue here.

8 **6.** The load shedding scheme that would be required in the absence of
9 synchronous condensers at HB 3&4 would result in load being shed when
10 a particular N-1-1 contingency occurs, meaning that one major
11 transmission element first fails and is followed by the loss of a second
12 major transmission element during the period before restoration of the first
13 element can be achieved. By contrast, the Path 15 and Path 26 load
14 shedding schemes are designed to address an N-2 contingency where
15 two major transmission elements simultaneously fail.

16 **7.** Under the transmission planning standards[1] adopted by NERC, the N-2
17 contingencies for Paths 15 and 26 are each classified as a Category D
18 contingency, while the N-1-1 contingency that the ISO is seeking to
19 address here with synchronous condensers is defined by NERC as a
20 Category C contingency. This distinction is important because the
21 classification scheme is designed to take into account the likelihood or
22 remoteness of the risk that the contingency will come to pass. A Category
23 D contingency is considered by NERC to be less likely to occur, and thus

[1] TPL 001, TPL 002, TPL 003, and TPL 004.

1 the measures that must be taken as a matter of transmission planning to
2 mitigate the contingency are less stringent. Because the type of
3 contingencies at issue are not the same and the load shedding schemes
4 in place for Paths 15 and 26 are designed to address a more remote
5 circumstance, those protection schemes do not establish a precedent for
6 relying upon a load shedding scheme for the more likely N-1-1
7 contingency at issue here.

8 **8.** Mr. Mackin's Affidavit potentially causes some confusion in its discussion
9 of the Path 15 and Path 26 protection schemes by stating that they are
10 designed to address outages that fall into "NERC/WECC Category 'C-5'".
11 This creates the misimpression that NERC has categorized such N-2
12 outages as falling within Category C. In fact, NERC has classified these
13 contingencies as Category D. While there is a separate WECC criterion[2]
14 that requires entities in the WECC area to treat certain NERC-classified
15 Category D common mode contingencies, like those at issue for the Path
16 15 and Path 26 contingencies, as though they were in Category C, this
17 does not change the fundamental fact that these are N-2 contingencies
18 that NERC has determined are inherently less likely to occur than the N-1-
19 1 contingency at issue here.

20 **9.** Mr. Mackin also makes reference to a load shedding scheme associated
21 with the Santiago substation. The information he cites actually refers to
22 two different schemes. During the period of 2009-2011, there was a load
23 shedding scheme in place at this facility that was designed to address a

[2] TPL-001-WECC-CRT-2 System Performance Criterion.

1 scenario in which one or more generating units are unavailable during
2 peak load conditions and the loss of two major transmission elements
3 occurs. This load shedding scheme monitored the net of load and
4 generation in the local area and when the local load was near summer
5 peak load levels and at least one of the local generation units was not
6 available, the net load level would have exceeded the arming level. When
7 the arming level was exceeded load would be shed for the N-2
8 contingency. This G-1/N-2 scenario is a Category D contingency that is
9 more remote than the N-1-1 scenario at issue here.

10 **10.** When Mr. Mackin refers to a Santiago SPS that was not actually put into
11 place until 2012 (Mackin Affidavit, ¶ 16), he appears to be referring to a
12 different scheme that was temporarily put in place on an emergency basis
13 after the SONGS units unexpectedly went out of service in early 2012.
14 This scheme was designed to provide protection against an undervoltage
15 situation prior to the completion of transmission upgrades needed to
16 address the unexpected extended outage of both SONGS units. While
17 establishing such a back-up protection scheme on a emergency basis was
18 prudent practice, this is far different from relying upon a load shedding
19 scheme as part of the ISO's annual transmission planning for a scenario
20 that is entirely avoidable through other measures, such as deployment of
21 the synchronous condensers at HB 3&4.

22 **11.** J.P. Morgan suggests that testimony I gave in a 2012 proceeding at the
23 California Public Utilities Commission ("CPUC") was inconsistent with my

1 November 15 Declaration in this proceeding. *See* JPM Protest at 2. This
2 is incorrect and mischaracterizes my CPUC testimony. For reference, my
3 testimony is posted on the ISO's website at the following link:
4 http://www.caiso.com/rules/Pages/Regulatory/RegulatoryFilingsAndOrders
5 .aspx.

6 **12.** My testimony was provided in the CPUC's Long-Term Procurement
7 proceeding and discussed various studies the ISO had undertaken
8 regarding generation needs. At page 10, as J.P. Morgan notes, I made
9 reference to an existing load shedding scheme at Santiago for a Category
10 D contingency. J.P. Morgan suggests that by mentioning this load
11 shedding scheme and not criticizing its use, I somehow endorsed the load
12 shedding scheme as desirable. This claim is misleading in two respects.
13 First, J.P. Morgan fails to mention that the referenced scheme was for an
14 N-2 contingency with a line already out of service, which is a Category D
15 contingency and thus is not a precedent for relying upon a load shedding
16 scheme in the different N-1-1 scenario at issue here. Second, J.P.
17 Morgan incorrectly suggests that my testimony was neutral regarding
18 whether such a scheme should be relied upon rather than development of
19 alternative resources that would obviate the need for it. In fact, in the next
20 sentence, I stated: "On the other hand, generation in the Ellis subarea is
21 highly effective at mitigating the Western LA Basin constraint, and is one
22 of the most effective locations for replacing SONGS in any scenario where
23 SONGS is not available on a short or long-term basis." *See* CPUC

Testimony at 10. This statement supports the procurement of additional resources as a means to avoid reliance on the protection scheme. Moreover, at the conclusion of my testimony, I reiterated the need for more generation in this subarea and stated that the ISO "recommends the long-term procurement of these amounts of replacement OTC generation, to ensure the continued reliable operation of the ISO transmission system." *See* CPUC Testimony at 17.

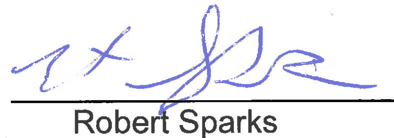
C. Discussion of Fire Risk Data

13. In my November 15 Declaration, I discussed various factors that increased the risk that an N-1-1 outage would occur on the facilities at issue in this proceeding. One of the factors I discussed, among others, was the risk of fire in the vicinity of the relevant facilities. I cited data supplied in a report by SDG&E establishing that, over the last 13 years, there had been 11 fires in an area where the two transmission lines at issue are relatively close together, including one fire that spanned an area that would have taken out the two lines at issue in the ISO's N-1-1 analysis.

14. J.P. Morgan contends that the statistical risk of an outage is much less than this data suggests based on other data SDG&E included in its report analyzing the overall risk of certain outages. The data that J.P. Morgan points to is irrelevant because it relates to a different outage than the one at issue here. That data, which establish a range of 21 to 928 years as the interval over which a particular outage could be expected to occur, related to a simultaneously occurring N-2 outage of the transmission

1 facilities that were studied, Because that data related to a different and
2 more severe type of outage, it cannot be used to establish the risk for the
3 N-1-1 outage at issue in the current proceeding.

4 **15.** In fact, it is especially inappropriate to rely on such N-2 outage data as a
5 proxy for the outage risk for an N-1-1 contingency where, as here, the two
6 relevant transmission facilities are on separate towers located several
7 miles apart. In this context, the risk of an N-2 contingency is much more
8 remote because a physical event that endangers the two lines – such as a
9 fire – is extremely unlikely to cause an outage of both facilities at exactly
10 the same time. Because fires do often spread within a relatively short
11 period of time, an N-1-1 contingency, where the second facility is affected
12 shortly thereafter, is more likely. Thus the application of N-2 data to an N-
13 1-1 contingency is not only irrelevant but also inherently understates the
14 risk of the contingency that is actually at issue in this proceeding.
15
16 I declare under penalty of perjury that the foregoing facts are true and correct to
17 the best of my knowledge and belief.
18



19 Dated: December 17, 2012
20 Robert Sparks

CERTIFICATE OF SERVICE

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

Dated at Washington, DC this 17th day of December, 2012.

/s/ Katharine E. Leesman
Katharine E. Leesman
Van Ness Feldman, LLP