

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

California Independent System Operator
Corporation

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Docket No. EL02-45-000

**MOTION FOR CLARIFICATION, REQUEST FOR REHEARING
AND CONDITIONAL MOTION FOR STAY OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

I. INTRODUCTION AND SUMMARY

A. INTRODUCTION

Pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 251(a) (2001), and Rules 212 and 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713, the California Independent System Operator Corporation (“ISO”) hereby submits this Motion for Clarification, Request for Rehearing, and Conditional Motion for Stay of the Commission’s May 10, 2004, Order issued in the above-captioned docket.¹

As explained below, the Commission should clarify that, in the course of addressing the allocation of the costs the ISO incurs to fulfill its obligations under the ISO Tariff to procure Ancillary Services to maintain the reliability of the ISO Controlled Grid and to fulfill its obligations in managing the California Control Area in accordance with Western Electricity Coordinating Council (“WECC”) requirements, the Commission did not intend to restrict the

¹ *California Independent System Operator Corporation*, 107 FERC ¶ 61,152 (2004) (“*May 10 Order*”).

ISO's authority to establish standards for Ancillary Services and to determine the quantities of Ancillary Services required in accordance with the WECC's Minimum Operating Reliability Criteria ("MORC").² The ISO Tariff unambiguously provides the ISO with the discretion, subject only to those criteria as a minimum and to good utility practice, to determine the standards and quantities necessary to ensure reliability of the ISO Controlled Grid. Unless it is promptly clarified, the *May 10 Order* presents the ISO with a significant dilemma: if the Commission intended to require the ISO to disregard firm Control Area loads served by transactions that do not use the ISO Controlled Grid in determining the quantities of Ancillary Services the ISO procures, then the ISO cannot comply with the applicable WECC reliability requirements and the provisions of the ISO Tariff incorporating those requirements as a minimum.³ If the Commission intended to impose such a restriction, it should accordingly grant rehearing and promptly reverse that ruling.

The Commission should also grant rehearing to reverse its ruling that no portion of the costs of ISO-procured Ancillary Services⁴ may be allocated to Scheduling Coordinators for loads in the ISO Control Area that are not served by transactions using the ISO Controlled Grid. That ruling is inconsistent with the Commission's rulings in prior cases, with the controlling

² Words and phrases used herein with initial capitalization and without specific definition are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

³ The *May 10 Order* potentially places the ISO in the untenable position of having to take actions (as a Control Area operator) to comply with WECC reliability requirements -- actions that the Commission might find are inconsistent with the ISO's Tariff authority. Failure to comply with WECC reliability requirements can result in Commission-approved WECC sanctions being levied against the ISO. See *Western Systems Coordinating Council*, 87 FERC ¶ 61,060 (1999). The Commission recognized that WECC criteria required Control Areas to maintain specified levels of operating reserves and continually balance generation and Interchange schedules to load and maintain frequency. *Id.*

⁴ References to the cost of Ancillary Services in this motion include both the cost of Ancillary Services and other services procured by the ISO in order to support the reliable operation of the ISO Control Area.

provisions of the ISO Tariff, with the record evidence before the arbitrator, and with well-settled principles of cost causation.

B. SUMMARY OF ARGUMENT

1. The Commission should clarify that it did not intend in the *May 10 Order* to go beyond the only issue before the Commission in this proceeding: whether to affirm the ruling of the arbitrator that the ISO may not allocate any portion of the costs of procuring Ancillary Services to Scheduling Coordinators for load within the ISO Control Area that are not served by transactions using the ISO Controlled Grid. Some statements in the *May 10 Order* might be read out of context to suggest that, in the course of addressing this issue, the Commission ruled that the ISO may not take into consideration all loads within its Control Area in determining the quantities of Ancillary Services required to maintain the reliability of the ISO Controlled Grid to meet its obligations to manage the Control Area in accordance with WECC MORC requirements. The ISO believes that the Commission did not intend to issue such a ruling, which would be contrary to the provisions of the ISO Tariff and the requirements of the WECC, as set forth in unchallenged evidence in the record. Such a ruling would impair the ability of the ISO to manage real-time conditions in its Control Area, thereby threatening reliability. Accordingly, the ISO requests that the Commission clarify that it did not intend to restrict the ISO's authority to determine the quantities of Ancillary Services required to reliably operate the ISO Controlled Grid and to meet its Control Area obligations in accordance with WECC requirements.

2. If, contrary to the ISO's belief, the Commission did intend to restrict the ISO's authority to take all loads in its Control Area into account in determining the quantities of Ancillary Services required to maintain reliability and comply with WECC requirements, it should grant rehearing to reverse that ruling. The provisions of the ISO Tariff explicitly authorize and require the ISO to determine the standards for and quantities of Ancillary Services

required to maintain the reliability of the ISO Controlled Grid in accordance with WECC requirements, and any more stringent criteria the ISO may adopt. Further, MORC Sections I.A.1 and I.A.3. require that each Control Area maintain minimum Operating Reserve (including regulating reserve and contingency reserve) levels at all times. Indeed, the evidence before the arbitrator established, without contradiction, that the WECC requirements for Ancillary Services are based on all firm loads within in a Control Area, without regard to whether or not the transactions that serve such loads use the Control Area operator's transmission facilities. The evidence was equally clear that the ISO in fact uses Ancillary Service capacity that it procures to ensure reliable service to all loads in its Control Area, including loads served by transactions that do not use the ISO Controlled Grid. If the ISO were precluded from taking such loads into account, it would have insufficient Ancillary Services available to satisfy the WECC MORC requirements. Consequently, the ISO would be in violation of its obligations under the ISO Tariff, and its ability to manage real-time operating conditions would be severely impaired. Both the reliability of the ISO Controlled Grid and the reliability of electric service within the ISO's Control Area would suffer. Accordingly, the Commission should grant rehearing to reverse the *May 10 Order* to the extent it ruled that the ISO must disregard Control Area loads served by off-ISO Controlled Grid transactions in establishing its Ancillary Service requirements.

3. The Commission should also grant rehearing of its ruling that no portion of the costs of ISO-procured Ancillary Services may be allocated to Scheduling Coordinators' off-ISO Controlled Grid loads. The Commission has ruled on several occasions that all entities that execute a Scheduling Coordinator Agreement with the ISO are subject to all the obligations that the ISO Tariff imposes on Scheduling Coordinators. In one of those cases, the Commission specifically ruled that Pacific Gas and Electric Company ("PG&E") – which has executed a

Scheduling Coordinator Agreement – has the obligations of a Scheduling Coordinator with respect to the off-ISO Controlled Grid loads at issue in this case. Moreover, because those loads are included in calculating the firm load in the Control Area load, such loads contribute to the ISO's Ancillary Services requirements under MORC. Further, such loads benefit from the Ancillary Service capacity the ISO procures because the ISO uses that capacity to maintain the minute-to-minute balance between loads within its Control Area and the resources available to serve them. Consistent with these facts and legal obligations, the ISO Tariff provides that the ISO's costs of Ancillary Services are to be allocated among *all* Scheduling Coordinators in proportion to the loads they represent. The Commission erred in the *May 10 Order* by excluding the off-ISO Controlled Grid loads represented by PG&E from this obligation.

II. BACKGROUND

PG&E has executed a Scheduling Coordinator Agreement with the ISO. Pursuant to agreements with a number of other California utilities, PG&E submits Schedules to the ISO for transactions that use the California-Oregon Transmission Project (“COTP”). The COTP is a jointly owned transmission facility and only certain limited Entitlements to the capacity of the COTP have been turned over to the ISO. The transactions at issue involve the use of other portions of the COTP for deliveries of electricity to serve loads that are located within the Control Area operated by the ISO pursuant to Section 2.3.1.1.1 of the ISO Tariff.⁵

Following protracted negotiations, PG&E filed a Statement of Claim against the ISO under section 13.2.2 of the ISO Tariff in October 2000, concerning charges for Ancillary

⁵ For convenience, these loads and transactions are sometimes referred to herein as “off-ISO Controlled Grid” loads and transactions, respectively.

Services (along with certain other costs) that the ISO procured in connection with transactions scheduled by PG&E on the COTP.⁶ PG&E sought reimbursement from the ISO for the amounts it paid to the ISO for Ancillary Services by mistake during the period between April 1998 and April 1999. In a Response to Claim and Counterclaim, the ISO denied that PG&E claim to reimbursement and sought recovery from PG&E for Ancillary Service costs incurred by the ISO since May 1, 1999, plus interest. The ISO also sought a declaration that PG&E is required to continue to pay for costs incurred by the ISO to support COTP Schedules and to continue to act as the COTP Scheduling Coordinator. The arbitration hearing proceeded in two phases in September and October 2001. On December 13, 2001, the Arbitrator issued his Final Order and Award, granting PG&E's claim and denying the ISO's counterclaim.⁷

On January 4, 2002, pursuant to section 13.4 of the ISO Tariff, the ISO filed a petition requesting that the Commission review the Arbitrator's order. The Commission established a briefing schedule for the appeal.

The ISO submitted its initial brief to the Commission on February 25, 2002, arguing that the ISO tariff provides authority to the ISO to charge for Ancillary Services procured in support of transactions within the ISO Control Area but not on the ISO Controlled Grid and that as Scheduling Coordinator for the COTP, PG&E is responsible for the Ancillary Services charges.

On March 27, 2002, PG&E submitted a reply brief to the Commission arguing that the ISO's appeal represented an attempt by the ISO to ignore the Tariff and charge PG&E for

⁶ Subsequently, similar statements of Claim and Petitions to Intervene were filed by Modesto Irrigation District; Cities of Redding and Santa Clara, M-S-R Public Power Agency and the Transmission Agency of Northern California ("TANC"); SMUD; and Turlock Irrigation District. The Northern California Power Agency filed a Petition to Intervene but not a Statement of Claim.

⁷ *Pacific Gas and Electric Co.*, American Arbitration Association Case No. 71 198 00711 00, at p. 21 (the "AAA Order").

transactions that did not occur on the ISO Controlled Grid. Intervenors TANC, Modesto, M-S-R Power, Cities, SMUD, the NCPA, and Turlock (collectively, Intervenors) filed a reply brief supporting PG&E, and requesting that the Commission affirm the arbitration award.

On April 16, 2002, the ISO submitted its rebuttal brief to the Commission arguing that that nothing in the briefs of PG&E, Intervenors, or SMUD contradicts the ISO's obligation pursuant to its Tariff to procure Ancillary Services to support transactions within the ISO Control Area.

On May 10, 2004, the Commission issued its Order affirming the arbitrator's award and denying the ISO's petition for review.

III. CONCISE STATEMENT OF SPECIFICATIONS OF ERROR

In accordance with Rule 713(c)(1), 18 C.F.R. § 385.713(c)(1), the ISO respectfully requests rehearing of the following errors in the *May 10 Order*:

1. If the Commission declines to clarify that it did not intend to preclude the ISO from procuring the quantities of Ancillary Services it determines to be necessary to reliably operate the ISO Controlled Grid and to meet its WECC obligations to manage the Control Area, then the Commission erred to the extent it ruled that the ISO may not take all load in its Control Area into account in determining the quantities of Ancillary Services required for those purposes.
2. The Commission erred in ruling that the ISO may not allocate a portion of the costs of Ancillary Services it procures to maintain the reliability of the ISO Controlled Grid and to meet its WECC obligations to manage the Control Area for all entities that submit Schedules to the ISO reflecting loads within the ISO

Control Area, including loads that are served in whole or in part by transmission lines, such as the COTP, that are not part of the ISO Controlled Grid but are in the ISO Control Area.

IV. MOTION FOR CLARIFICATION

In the *May 10 Order*, the Commission affirmed the arbitrator's decision. It noted, "The arbitrator framed the issue as whether the ISO had the requisite legal authority to impose upon PG&E charges for ancillary services in connection with transactions scheduled on the COTP and Bubble facilities. The arbitrator concluded that the ISO Tariff did not provide the ISO with authority to impose charges related to these transactions." *May 10 Order* at P. 5. That was the **only** issue before the Commission. However, in reaching its conclusion, the Commission made certain statements that could be interpreted as reflecting a ruling that the ISO may not take account of loads within its Control Area that are served by such transactions in determining how much Ancillary Service capacity the ISO requires to meet its obligations under the ISO Tariff.⁸ The ISO believes that the Commission did not intend to reach beyond the cost allocation question addressed by the arbitrator to limit the ISO's authority to determine the quantity of Ancillary Services it requires to maintain the reliability of the ISO Controlled Grid and comply with applicable WECC requirements and, for that purpose, to take into account all loads within the ISO Control Area, including those that are served by transactions that do not use the ISO

⁸ In particular, the Commission stated, "[T]he ISO is responsible for procuring ancillary services *only* for the ISO-controlled grid, and thus it may seek reimbursement of the costs of ancillary services from customers that use the ISO-controlled grid." *May 10 Order* at P. 28 (emphasis in original). The Commission also stated, "[W]e agree with the arbitrator that the ISO Tariff limits the ISO's authority to procure ancillary services to ISO-controlled grid transactions, and that the arbitrator correctly concluded that the ISO Tariff does not authorize the ISO to impose upon PG&E charges for ancillary services in connection with COTP and Bubble transactions since they are not included within the ISO-controlled grid." *Id.* at P. 29.

Controlled Grid. The ISO seeks clarification that its interpretation of the *May 10 Order* is correct.⁹

The ISO's belief that the Commission did not intend in the *May 10 Order* to limit the ISO's authority to determine the quantities of Ancillary Services necessary for reliability has several legal and factual bases.

First, the Commission made clear throughout the *May 10 Order* that the purpose of its ruling was to review and ultimately to "uphold the arbitration award." *May 10 Order* at P. 27; *see also id.* at PP. 1, 26. The only issue decided by the arbitrator was the propriety of the ISO's allocation of a portion of its Ancillary Service costs to PG&E in proportion to the loads reflected in its COTP Schedules. The arbitrator did not decide the issue of whether the ISO has authority to procure Ancillary Services based on Control Area transactions as opposed to ISO Controlled Grid transactions. In fact, none of the parties to the arbitration challenged the ISO's responsibility to abide by WECC or NERC reliability standards; none challenged the ISO Tariff's implementation of those standards. Indeed, before the Arbitrator, PG&E recognized the limitation of the arbitration and did not even take issue with the ISO's obligation and authority to acquire Ancillary Services in these circumstances. Rather PG&E only challenged the ISO's authority to recover the associated costs from the Scheduling Coordinator whose schedule imposed the requirement.¹⁰ The Commission too described the issue before it on review of the

⁹ As explained in Section V, below, if the Commission intended to limit the ISO's authority to determine the quantities of Ancillary Services required, the ISO seeks rehearing of that ruling.

¹⁰ PG&E stated as follows in its brief to the arbitrator:

The ISO also oversees a region known as the ISO Control Area. *Both the ISO Controlled Grid facilities and the Off Grid facilities are within the geographic boundaries of the ISO Control Area and, as mandated by the ISO Tariff, the ISO must operate that area in accord with NERC/WSCC guidelines.* However, while the ISO Tariff grants the ISO authority over the ISO Controlled Grid, the ISO Tariff does not grant the ISO any such authority over Off Grid facilities. Rather, the ISO Tariff merely indicates that the ISO will

(. . . continued)

arbitrator's decision as whether the ISO "has . . . shown that it has a right under a tariff or on equitable grounds to assess or recover the charges it seeks here." *Id.* at P. 33.

Significantly, the arbitrator did *not* rule that the ISO was required to determine the Ancillary Services it required without considering loads in its Control Area that were served by transactions using non-ISO Controlled Grid transmission facilities. To the contrary, the arbitrator expressly ruled that it was "within Cal ISO's judgment to determine what was required by its responsibility as operator of a Control Area wider than that which PG&E [had] operated." *AAA Order* at p. 20. He also recognized that the consequence of his ruling that PG&E should not be required to pay any of the ISO's Ancillary Service costs attributable to off-ISO Controlled Grid loads was that those costs would be borne by other Scheduling Coordinators. *Id.* at 20-21. Accordingly, if the Commission intended in the *May 10 Order* to limit the ISO's judgment as to the quantity of Ancillary Services the ISO is required to procure to meet that obligation, the Commission necessarily would have had to indicate that it was *reversing* the arbitrator's ruling on this issue. There is absolutely no indication in the *May 10 Order* that the Commission intended to do so. To the contrary, the Commission indicated that it decided to "uphold the arbitration award," without qualification.

Second, the Commission specifically declined to consider the ISO's arguments, in support of its position on the cost allocation question, that the ISO Tariff specifically authorizes the ISO to establish standards and procure Ancillary Services in an amount it concludes to be necessary to protect the reliability of the ISO Controlled Grid consistent with WECC and NERC

operate the ISO Control Area pursuant to NERC/WSCC guidelines. The fact that the ISO must comply with NERC/WSCC guidelines does not provide the ISO with any authority to assess charges on PG&E for Off Grid transactions. Authority to assess charges can only come from the ISO Tariff.

PG&E Post-Hearing Br. at 2-3 (emphasis added).

standards, and that those standards require the ISO to take account of all loads in its Control Area in order to protect the reliability of the Grid. *May 10 Order* at P. 29.¹¹ The *May 10 Order* can hardly be read to rule on an issue the Commission found to be outside the scope of its review of the arbitrator's decision.

Third, nowhere in the *May 10 Order* does the Commission explain how a limitation on the ISO's authority to determine the quantities of Ancillary Services necessary to meet its reliability obligations could be squared with the ISO's obligations under the ISO Tariff. Section 2.5.1 of the ISO Tariff states that "[t]he ISO shall be responsible for ensuring that there are sufficient Ancillary Services available to maintain the reliability of the ISO Controlled Grid consistent with WSCC and NERC criteria." The record evidence before the arbitrator was clear (and indeed undisputed) that the WECC MORC¹² require the ISO, as a Control Area operator, to maintain Ancillary Services based on *all* firm load in its Control Area.¹³ The evidence before the arbitrator was also undisputed that the MORC provide no exception for "firm control area load" served by transactions using transmission facilities not under the direct Operational Control of the Control Area operator.

The WECC's MORC criteria are specifically cited in several of the ISO Tariff sections establishing the ISO's responsibilities with respect to Ancillary Services. Tariff Section 2.5.2.1

¹¹ The Commission concluded that these arguments had not been raised before the arbitrator. In this respect, as the ISO noted in its Reply Brief, the Commission is incorrect; the ISO did raise these arguments before the arbitrator. As discussed below, the arbitrator recognized the ISO's need to procure Ancillary Services to fulfill its WECC and NERC responsibilities, but nevertheless found that the ISO's authority to procure such Ancillary Services did not constitute a sufficient basis for charging any of the associated costs to PG&E. *AAA Order* at 20.

¹² The Western Electricity Coordinating Council (WECC) was formed on April 18, 2002, by the merger of WSCC, Southwest Regional Transmission Association (SWRTA), and Western Regional Transmission Association (WRTA).

¹³ The WECC's MORC speak in terms of "load responsibility." MORC, at p. 2 (Exh. ISO-8 (R. 04669); Tariff § 2.5.2.1; Tariff § 2.5.2.3). The ISO's load responsibility includes the "*control area's* firm load demand." WECC Reliability Criteria, at IV.5 (Exh. ISO-8 (R. 04699) (emphasis added)).

authorizes and requires the ISO to establish Ancillary Service standards based on the MORC “and ISO Controlled Grid reliability requirements.”¹⁴ Tariff Section 2.5.3 gives the ISO exclusive authority to determine the quantity of each Ancillary Service the ISO requires. The subsections of that provision set forth requirements for Regulation, Operating Reserve, and Replacement Reserves, specifically referring to WECC and MORC standards in the first two cases.¹⁵ It is also noteworthy that Section 2.3.1.1 requires the ISO to “establish a WSCC approved Control Area and control center” to direct the operation of the ISO Controlled Grid and the operation of Generating Units providing Ancillary Services.

These provisions of the ISO Tariff, through incorporation of the WECC criteria as a minimum, do not merely authorize, but in fact require, the ISO to procure Ancillary Services not only for transactions on the ISO Controlled Grid, but also -- absent notification by a Scheduling Coordinator that Ancillary Services are being self-provided -- for all “firm load demand” in the ISO Control Area. If there is a contingency anywhere in the Control Area that affects the ISO’s Control Area error, and if the ISO has not ensured sufficient Ancillary Services to maintain the reliability of the Control Area consistent with WSCC criteria (*i.e.*, for all load), *a fortiori* the ISO has not ensured “sufficient Ancillary Services . . . to maintain the reliability of the ISO

¹⁴ The ISO’s tariff obligations in this regard are reinforced by the contractual participation in the WECC’s Reliability Management System, over which the Commission has exercised jurisdiction. *See Western Systems Coordinating Council*, 87 FERC ¶ 61,230 (1999).

¹⁵ Section 2.5.3.1 requires the ISO to maintain sufficient Regulation capacity to satisfy WECC and NERC criteria. Section 2.5.3.2 requires the ISO to maintain Operating Reserves *at least* sufficient to meet MORC requirements, which it then recites: 7 percent of Demand served by thermal Generation and 5 percent of Demand served by other Generation. Consistent with the MORC, that section does not limit the ISO to procuring Operating Reserve for Demands served by transactions on the ISO Controlled Grid. This provision also authorizes the ISO to establish requirements for Operating Reserves that are more stringent than the MORC criteria. The MORC criteria thus operate as a floor on the ISO’s authority to procure Ancillary Services, not a ceiling.

Controlled Grid consistent with WSCC and NERC criteria,” as required by Section 2.5.1 of the ISO Tariff.

Accordingly, it is clear that, notwithstanding some arguably ambiguous language, the *May 10 Order* did not explicitly nor implicitly limit the ISO’s authority (or excuse the ISO’s responsibility) under the ISO Tariff and the requirements of the WECC to take all loads in its Control Area into account in determining the quantities of Ancillary Services required to ensure the reliability of the ISO Controlled Grid. The ISO respectfully requests that Commission clarify that no such limitation was intended.

V. REQUEST FOR REHEARING

A. IF THE COMMISSION DOES NOT CLARIFY THE *MAY 10 ORDER*, IT SHOULD GRANT REHEARING TO CONFIRM THE ISO’S AUTHORITY AND RESPONSIBILITY TO DETERMINE THE AMOUNTS OF ANCILLARY SERVICES REQUIRED BASED ON THE TOTAL LOAD IN ITS CONTROL AREA.

If the Commission does not clarify that its *May 10 Order* permits the ISO to take into account the load within its Control Area that is served by deliveries over transmission lines that are not part of the ISO Controlled Grid (but which are within the ISO Control Area) in deciding the quantities of Ancillary Services necessary to protect the reliability of the ISO Controlled Grid, then the ISO respectfully seeks rehearing of the Commission’s decision.

To the extent the Commission intended to hold that the ISO’s authority is limited to the procurement of Ancillary Services proportionate to the loads connected to the ISO Controlled Grid, that decision is fundamentally inconsistent with the ISO Tariff provisions and WECC requirements discussed in Section IV, above. Any such conclusion necessarily proceeds from a fundamental misinterpretation of the ISO’s obligations as a Control Area operator member of the WECC and its obligations and discretionary authority under the Tariff. In particular, the

Commission's exclusive and unwarranted focus on the term "ISO Controlled Grid" in Section 2.5.1 of the ISO Tariff disregards broad authority specifically granted the ISO in that provision "to maintain the reliability of the ISO Controlled Grid consistent with [WECC] and NERC criteria." (emphasis added). As noted above, that authority and responsibility is also explicit in numerous other provisions of the ISO Tariff:

- Section 2.5.2.1 grants the ISO discretionary authority to determine standards for Ancillary Services "necessary to maintain the reliable operation of the ISO Controlled Grid . . . based on [WECC MORC]" (emphasis added) and to use those standards to determine quantities of Ancillary Services;
- Section 2.5.3 directs the ISO to determine "the quantity and location of the Ancillary Service which is required and must be under the direct Dispatch control of the ISO," and goes on to address each Ancillary Service in the following subsections;
 - Section 2.5.3.1 obligates the ISO to procure "sufficient . . . Regulation service to allow the system to meet [WECC] and NERC criteria" (emphasis added);
 - Section 2.5.3.2 obligates the ISO to maintain minimum Operating Reserve "in accordance with [WECC] MORC criteria" based on percentages of Demand in the Control Area, "or . . . by reference to such more stringent criteria as the ISO may determine from time to time" (emphasis added); and
 - ISO Tariff definitions in the Master Definitions Supplement, Appendix A refer to both "Operating Reserve" and "Regulation" as related to the [WECC] and NERC services for the "Control Area".

As also discussed above, the WECC criteria with which the ISO is directed to comply require the maintenance of Ancillary Service capacity based on specified percentages of "firm

control area load.” *These provisions establish unambiguously (1) that it is ultimately within the ISO’s exclusive authority, subject to good utility practice and minimum requirements, to determine the ISO’s standards and quantities of Ancillary Services; (2) that those standards and quantities must at a minimum meet WECC MORC criteria; and (3) that those standards and quantities must focus on the reliability of the ISO Controlled Grid, not just on the question of who is scheduling on the ISO Controlled Grid.*

Thus, the ISO Tariff’s repeated and consistent specifications that the ISO comply with WECC criteria in establishing Ancillary Services standards and quantities – which were not addressed in the *May 10 Order* – leave no doubt that the ISO can and must procure Ancillary Service capacity based on *all* Control Area loads, including off-ISO Controlled Grid loads. To say, as the Commission did, that the ISO is “responsible for procuring ancillary services *only* for the ISO-controlled grid,” *May 10 Order* at P. 28, therefore begs the question: it does not identify the *standard* to be used by the ISO for determining “sufficient” Ancillary Services to ensure grid reliability. The ISO Tariff and the record before the arbitrator are both clear: the ISO must procure at least enough Ancillary Services to satisfy the WECC’s MORC criteria, which require the ISO to take into account *all* firm loads in its Control Area.

There is good reason for the requirement that the ISO, as the operator of a Control Area, base its Ancillary Service procurement on all firm loads in the Control Area, including off-ISO Controlled Grid loads, so as to ensure the reliability of the ISO Controlled Grid. For instance, if a Generator serving load in the ISO’s Control Area through deliveries over the COTP experiences an unplanned shutdown, an imbalance between Generation and load in the ISO’s Control Area -- which includes off-ISO Controlled Grid loads-- will result. (Tr. 223:7-224:10 (R. 02272-02273); Tr. 1093:3-1094:20 (R. 03143-03142); Tr. 1156:20-1157:3 (R. 03206-03207).) If

that imbalance, which shows up in the ISO's monitoring systems, is not corrected, the reliability of the entire Control Area, including the reliability of the ISO Controlled Grid, will be put at risk. (*Id.*, Exh. ISO-8, MORC at 1-4 (R. 04668-04671).) Thus, a failure of supply delivered over non-ISO Controlled Grid transmission facilities can affect "the reliable operation of the ISO Controlled Grid." ISO Tariff, § 2.5.2.1.

Moreover, the Ancillary Service capacity procured by the ISO must be sufficient to protect against the failure of Generation serving all loads in the ISO's Control Area, including off-ISO Controlled Grid loads. When an imbalance between firm Control Area loads and available resources develops, the ISO corrects the imbalance by using Ancillary Service capacity: first, units with Automatic Generation Control that are providing Regulation will respond with Energy to replace the lost Generation; subsequently, the ISO will Dispatch Energy from Operating Reserves or Supplemental Energy Bids to bring those units back to their preferred operating points. ISO Tariff § 2.5.22.2. Tr. 1156:20 – 1157:23 (R. 03206-03297). The Ancillary Service capacity available to the ISO thus is used to respond to failures of a supply resource serving any load in the ISO's Control Area, regardless of whether the resource is delivered over transmission facilities included in the ISO Controlled Grid or over COTP. Thus, the WECC criteria referenced in the ISO Tariff, which base a Control Area's minimum Ancillary Service capacity obligations on *all* firm Control Area load, reflect a basic operational reality that is critical to maintaining reliable service.

The Ancillary Services procurement at issue in this proceeding was consistent with and in fulfillment of this tariff authority and the ISO's obligations under MORC. The unrebutted testimony before the arbitrator established that the ISO's Ancillary Services standards and quantities are based on WECC criteria. *See, e.g.* Tr. 1208: 23-25. Under those criteria, the ISO

is responsible for monitoring the area control error, or frequency deviation for the entire Control Area. (Tr. 1271:6 – 1277:7.) In order to respond immediately to these Control Area deviations, the ISO must have, *under its control*, adequate Regulation. *Id.*, Tr. 1280:19-22. In order to respond and restore balance following such disturbance, the ISO must maintain adequate Operating Reserves. Tr. 1277:8-1278:18. The ISO uses this Ancillary Service capacity to match deviations in the output of resources serving loads in the ISO's Control Area, including off-ISO Controlled Grid loads. The WECC, and therefore ISO Tariff, Ancillary Service requirements reflect the ISO's load responsibility as a Control Area operator – i.e. the *Control Area* load. Exh. ISO-8.

Any interpretation of the ISO Tariff provisions that requires the ISO to turn a blind eye to off-ISO Controlled Grid loads and other conditions not directly involving the ISO Controlled Grid would represent a grave threat to reliability. The Commission certainly recalls the genesis of last August's blackout in the Northeast United States and Canada, in which the failure of transmission lines and power plants in the Ohio initiated a cascading failure on the interconnected electrical grid, which ultimately left about 50 million people in eight states and Ontario without electricity. The ISO would be reckless to disregard events and conditions beyond the facilities under its control.

Accordingly, if the Commission declines to grant the clarification requested in Section IV, above, it must determine whether an ISO decision not to procure Ancillary Services for transactions that *affect* the ISO Controlled Grid because they serve load in the ISO's Control Area, even though such transactions are not using the ISO Controlled Grid, would affect the reliability of the ISO Controlled Grid in violation of WECC and MORC standards. If the Commission believes that the procurement of such Ancillary Services is not necessary to

maintain the reliability of the ISO Controlled Grid (and therefore not authorized by the ISO Tariff) **or** to satisfy WECC and MORC requirements, then the Commission should state that clearly. But the Commission cannot rationally acknowledge that such Ancillary Services are necessary to maintain the reliability of the ISO Controlled Grid or to meet WECC and MORC requirements, and then conclude that Section 2.5.1 of the ISO Tariff does not authorize the ISO to procure them.

B. THE COMMISSION SHOULD GRANT REHEARING TO CONFIRM PG&E'S OBLIGATION TO PAY FOR ANCILLARY SERVICES PROCURED BY THE ISO FOR PG&E SCHEDULED LOAD ON THE COTP.

The Commission has provided no reasoned basis for its conclusion that PG&E is not required to bear a share of the ISO's Ancillary Services costs proportional to the loads in its COTP Schedules. The Commission does not question (or even discuss) the obligations of Scheduling Coordinators under the ISO Tariff. Instead, it seems to rest on its adoption of the arbitrators' factual finding that "finding that the PG&E never agreed to schedule COTP transactions as an ISO Tariff certified scheduling coordinator nor did PG&E ever agree to pay for any charges, including the ancillary services charges, related to those transactions." *May 10 Order* at P. 22. This finding, however, is inconsistent with the Commission's own rulings and with the record evidence. It cannot support the Commission's affirmation of the arbitrator's decision to shield PG&E from responsibility for a portion of the Ancillary Service costs the loads in its Schedules cause the ISO to incur.

1. Section 2.5.1 of the Tariff Requires that PG&E, As a Scheduling Coordinator, Pay for Ancillary Services for Load that it Schedules With the ISO

The evidence before the arbitrator established beyond dispute that PG&E is a Scheduling Coordinator, as defined in the ISO Tariff. PG&E executed a Scheduling Coordinator

Agreement, and was certified as a Scheduling Coordinator. PG&E Exh. 6 (R. 4379); *see also* Tr. 58:25-59:2 (R. 3861); 512:17-20 (R.3976). A certified Scheduling Coordinator executes only one Scheduling Coordinator Agreement even though the Scheduling Coordinator may be issued several Scheduling Coordinator IDs. ISO Exh. 18, ¶¶ 3 & 9; Tr. 895:1-2 (R. 4846, 4848). Because there is only one category of Scheduling Coordinator pursuant to the ISO Tariff, absent competent evidence of some amendment or modification to the agreement, PG&E was required to meet all of the obligations of a Scheduling Coordinator, which included the obligation to pay for Ancillary Services procured by the ISO for its scheduled load. ISO Tariff § 2.5.20.1. Absent any evidence of mutual assent to amend the SC agreement, the standard SC agreement terms apply. Because there is no evidence that the ISO and PG&E ever agreed to modify the Scheduling Coordinator Agreement to absolve PG&E of its obligations,¹⁶ PG&E remained obligated to pay for Ancillary Services procured by the ISO for PG&E's scheduled load.¹⁷

The evidence is also undisputed that PG&E submitted Schedules for COTP transactions. Under Section 2.5.20.1 of the ISO Tariff, the ISO's Ancillary Service costs are allocated to Scheduling Coordinators in proportion to the metered loads they represent. As a Scheduling Coordinator, PG&E thus is responsible for a share of the ISO's costs of Ancillary Services proportional to the off-ISO Controlled Grid loads it represents.

Not only does the undisputed evidence before the arbitrator establish PG&E's status as a Scheduling Coordinator with all of the attendant obligations, but the Commission itself has explicitly confirmed PG&E's status as a Scheduling Coordinator with respect to the non-ISO

¹⁶ The ISO did present evidence during the arbitration of an agreement between the ISO and PG&E to exclude GMC charges from the standard SC agreement.

¹⁷ The ISO and PG&E did execute an agreement that exempted PG&E from certain charges related to COTP transactions. Significantly, Ancillary Services charges were not among those exempted. The arbitrator, erroneously in the ISO's view, found this agreement inadmissible.

Controlled Grid transactions at issue here. The Commission first recognized PG&E's status as a Scheduling Coordinator with full responsibility for the COTP Schedules in *Pacific Gas and Elec. Co.*, 93 FERC ¶ 61,322 (2000). That case involved PG&E's attempt to amend the COA, pursuant to which PG&E had the obligation to schedule COTP transactions, and remove itself from its role as the COTP Scheduling Coordinator. (Exh. ISO-3 (R. 04547); ISO Exh. 14 (R. 04736).) (Exh. ISO-2 (R. 04452).) The Commission concluded that PG&E was the COTP Scheduling Coordinator and could not avoid its obligations without properly assigning its role to another entity (which it has never done):

PG&E purports to merely reflect the reality of its changing role, and the new role of the ISO, under electric restructuring in California. However, PG&E's filing is more than a mere ministerial filing to substitute reference to PG&E with references to the ISO with regard to duties *currently* being performed by the ISO. It is apparent from PG&E's filing – and its answer removes any doubt – that PG&E also proposes to cease performing scheduling functions that it is currently performing for COTP participants.

. . . We agree with the Intervenors that PG&E is, in effect, attempting to assign its scheduling coordinator duties and responsibilities to some other entity. . . .

Id. at 62,104-05 (emphasis added). The Commission denied PG&E's request that the Commission reconsider on rehearing its finding that "PG&E was attempting to 'assign' to a third party scheduling coordinator duties and obligations under the COA." *Pacific Gas and Electric Company*, 94 FERC ¶ 61,204 at 61,770 (2001); *see also* ISO Exh. 4 at 1 (R. 04556). In this case, the Commission should have applied its finding that PG&E has "scheduling coordinator duties and obligations" with respect to COTP Schedules to its logical conclusion: PG&E is responsible for a share of the ISO's Ancillary Service costs proportional to loads it represents as a Scheduling Coordinator.

The Commission failure to reach this conclusion is also contrary to its decision in *California Independent System Operator Corp.*, 97 FERC ¶ 61,151 (2001), which concerned the

attempt of another Scheduling Coordinator, the California Department of Water Resources (“DWR”), to avoid some of the obligations associated with its scheduling of certain transactions. The Commission ruled that DWR “functions as the Scheduling Coordinator” and therefore was financially responsible for any transactions scheduled by the ISO on its behalf:

We note that DWR has already executed a Scheduling Coordinator Agreement with the ISO. This agreement includes, among other things, an obligation by DWR to abide by and perform *all of the obligations under the ISO Tariff, without limitation*. This includes an obligation to pay for scheduled and unscheduled transactions made on the Scheduling Coordinator's behalf by the ISO. . . . Although this agreement was entered into prior to SoCal Edison and PG&E losing their creditworthy status, nothing in the agreement limits the scope to DWR's scheduling of its own load, or distinguishes DWR's functioning as the creditworthy party for the net short position for the non-creditworthy UDCs. . . . Therefore, because DWR has assumed responsibility for purchases by the ISO, and because DWR functions as a Scheduling Coordinator for this net short position of PG&E and SoCal Edison, DWR must abide by the requirements of the ISO Tariff and the Scheduling Coordinator Agreement.

97 FERC at 61,659 (emphasis added). Like DWR, PG&E “has . . . executed a Scheduling Coordinator Agreement with the ISO [which] . . . includes, among other things, an obligation . . . to abide by and perform all of the obligations under the ISO Tariff, without limitation [.] include[ing] an obligation to pay for scheduled and unscheduled transactions made on the Scheduling Coordinator's behalf by the ISO.” *Id.*

The Commission failed to give effect to these rulings, or even to acknowledge them, when it affirmed the arbitrator’s decision, thereby allowing PG&E to avoid its obligation as a Scheduling Coordinator to pay a share of the ISO’s costs of procuring Ancillary Services to meet its obligations to secure the reliability of the ISO Controlled Grid and to operate the ISO Control Area in conformance with WECC requirements. The Commission’s failure to give effect to its prior rulings, or to provide a rational basis for distinguishing them, and its failure to hold that PG&E was estopped from contesting its status as a Scheduling Coordinator for the COTP

Schedules, constitutes arbitrary and capricious decision-making. *See, e.g., ANR Pipeline v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995).

2. The Commission’s Rejection of Amendment No. 2 Does Not Excuse PG&E’s Responsibility as a Scheduling Coordinator for a Proportionate Share of the ISO’s Ancillary Service Costs.

The Commission’s reliance on its rejection of Amendment No. 2 to excuse PG&E from its obligation as a Scheduling Coordinator to bear a share of the ISO’s Ancillary Service costs (*May 10 Order* at P. 30) is misplaced. As the ISO has explained, a principal objective of Amendment No. 2 was to clarify that a Scheduling Coordinator was required for all transactions within the ISO’s Control Area whether or not the transaction took place on the Controlled Grid.¹⁸ This issue has no bearing on the present dispute because, as explained above, PG&E is unquestionably a Scheduling Coordinator, both for the COTP Schedules and the other Schedules it submits to the ISO. Moreover, as explained above, the numerous references in the ISO Tariff to the ISO’s obligation to procure Ancillary Services in accordance with the WECC’s MORC requirements – which are based on the “firm control area load” – make it clear that Amendment No. 2 was *not* submitted to extend the ISO’s authority to procure Ancillary Services to non-ISO Controlled Grid transactions. Because PG&E’s Scheduling Coordinator status was not

¹⁸ For example, in the filing letter submitted to the Commission with Amendment No. 2 to the ISO Tariff, the ISO noted

The design of the California forward markets for Energy and Ancillary Services, and the reliable operation of the ISO Control Area in real-time, is founded on the premise that Generation and Demand within the Control Area, as well as all interties with neighboring Control Areas, are to be scheduled and/or bid with the ISO through Scheduling Coordinators.

(Exh. PG&E-1 at 5 (R. 04621).) The ISO pointed out:

Without a Scheduling Coordinator to submit the scheduled uses of transmission capacity into, out of, or through the ISO Control Area, whether across the ISO Controlled Grid . . . or other facilities owned by others within the ISO Control Area, the power simply cannot be scheduled with the ISO and cannot flow in accordance with NERC and WSCC accepted scheduling practices.

implicated by Amendment No. 2, the Commission’s reliance in the *May 10 Order* on the assertion that, in rejecting the amendment, the Commission “effectively rejected the ISO’s request to extend its authority to procure ancillary services to non-ISO Controlled grid transactions” is simply wrong. In rejecting Amendment No. 2, the Commission *did not even address* the ISO’s existing ability (under the Tariff provisions discussed above) to procure the Ancillary Services to meet MORC requirements or to allocate its Ancillary Service costs to existing Scheduling Coordinators in proportion to the loads they represent. *California Indep. Sys. Oper. Corp.* 82 FERC ¶ 61,312 (1998).¹⁹ Rather, in explaining its decision, the Commission simply agreed with statements that Amendment No. 2 would expand the operational control of the ISO over transmission facilities not under its control. 82 FERC at 62,241. Nothing in the instant case touches on the degree of ISO control (or lack of control) over the COTP. Amendment No. 2 therefore is irrelevant to the issue in this case and its rejection provides no support for the Commission’s affirmation of the arbitrator’s decision.

3. To the Extent the Commission Relied Upon PG&E’s Self-Provision Arrangements with COTP Participants, Those Arrangements Do Not Support the *May 10 Order*.

In the *May 10 Order* (at P. 31), the Commission accepted the arbitrator’s finding that PG&E “had agreements in place that included ancillary service self-provision arrangements for COTP and Bubble transactions.” It is not clear what bearing this finding had on the Commission’s affirmation of the arbitrator’s decision, inasmuch as the arbitrator did not rely upon this finding. To the extent that the Commission relied upon this finding, it provides no

¹⁹ The Commission did not even address the ISO’s ability to assess any charges with regard to unscheduled transactions. Indeed, it *explicitly* reserved the Grid Management Charge for a separate proceeding, *id.* at 62,241, and in a later proceeding confirmed that decision, *California Independent System Operator Corp.*, 82 FERC ¶ 61,348 (1998).

support for the *May 10 Order*. As discussed below, the only relevant evidence establishes that PG&E's contracts do not even cover all of its Ancillary Service obligations and PG&E did not comply with the ISO Tariff's requirements for self-provided Ancillary Services. Accordingly the provisions in its contracts with COTP Participants – to which the ISO is not a party -- did not relieve the ISO of its obligation to procure Ancillary Services for the load service by the COTP transactions in question.

As discussed above, Section 2.5.2.1 provides the ISO with the authority to establish the standards for the Ancillary Services that it believes are necessary to ensure the reliability of the ISO Controlled Grid. Self-provided “ancillary services” that do not meet those standards are thus of little or no assistance to the ISO in fulfilling its reliability responsibilities. To allow Scheduling Coordinators to “self-provide” in derogation of those standards, as would the arbitrator's order, negates the entire purpose of the procurement of Ancillary Services.

For example, the record evidence establishes that the self-provision arrangements in question were insufficient to meet the ISO requirements for Regulation. Under WECC criteria, Automatic Generation Control must be under the control of the Control Area operator. The unrebutted evidence demonstrated that none of the COTP participants (with the recent exception of SMUD) had been certified by the ISO to self-provide Regulation service, or had provided the ISO with any Automatic Generation Control over their respective generating units. ISO Exh. 16 at ¶ 14 (R. 04842-43). Indeed (except for SMUD), none of them had arrangements to self-provide Regulation under their Interconnection Agreements with PG&E. Exh. MID-1 at 43-44 (R. 05938-05939); Exh. TID-2 at 41-42 (R. 06176-06177). There is also no evidence that PG&E was providing Regulation on their behalf. Under such circumstances, in the event of an Area Control Error, none of the COTP participants were providing the ISO with any services upon

which it could call to respond to the error. To suggest that Regulation was “self-provided” when it was unavailable to the ISO makes no sense. Because Regulation was not self-provided and could not be self-provided under these circumstances, the ISO had to include the loads in PG&E’s COTP Schedules in determining the quantities of generating capacity capable of supplying Regulation that it needed to procure in order to meet its Control Area Operator and Tariff responsibilities.

Similarly, with regard to other Ancillary Services, the ISO Tariff imposes specific requirements on Scheduling Coordinators that wish to self-provide Ancillary Services and thereby to relieve the ISO of the need to procure Ancillary Services on their behalf. *See* ISO Tariff §§ 2.5.20.5 – 2.5.20.7. As the uncontested evidence before the arbitrator made clear, the ISO must receive verifiable, timely information establishing the adequate self-provision of Ancillary Services in the Schedules submitted to it in order to credit that self-provision. *See, e.g.,* Tr. 646:13-23, (R. 02694). As the arbitrator found, neither PG&E nor the COTP participants provided the ISO with any information regarding the purported self-provision of Ancillary Services when the Schedules were submitted or complied with the ISO Tariff’s other requirements relating to self-provision. *AAA Order* at 15; *see also* ISO Exh. 24 (R. 04919). This left the ISO with no choice but to procure the additional Ancillary Services for the loads in PG&E’s COTP Schedules in order to comply with the WECC MORC requirements to procure the necessary additional Ancillary Services. Tr. 1274:16-1275:16, (R. 03324-03325).

Under these circumstances, the contractual provisions between PG&E and the COTP Participants cannot relieve PG&E of its obligations as a Scheduling Coordinator to bear a proportionate share of the ISO’s Ancillary Services costs. Those provisions provide no support for the *May 10 Order*.

4. **The May 10 Order Constitutes Arbitrary and Capricious Decision-making in That It Produces Illogical Results**

The Commission is obligated to interpret tariffs, including the ISO Tariff, in a manner that avoids illogical results. A tariff must have a reasonable construction that does not yield unfair, unusual, absurd, or improbable results. *Penn Central Co. v. General Mills, Inc.*, 439 F.2d 1338, 1340 (8th Cir. 1971).

The *May 10th Order* must be reversed precisely because it leads to absurd results. Under the ISO Tariff and the Commission's orders, the ISO is the Control Area operator, and as such, it must comply with the WECC MORC. *Pacific Gas & Electric Co.*, 81 FERC ¶ 61,122 at 61,456 (1997); ISO Tariff § 2.3.1.3.1. The arbitrator recognized as much. *AAA Order* at 20. As explained above, the WSCC MORC require the ISO to maintain Regulation and Operating Reserves based on the entire firm load in the ISO Control Area, not just that load located on the ISO Controlled Grid. Exh. ISO-8 at 2 (R. 04669). To the extent that Ancillary Services are not self-provided, the ISO must procure them. ISO Tariff § 2.5.1. This responsibility is consistent with the Control Area operator's role as Ancillary Services provider of last resort under Order No. 888.²⁰ Indeed, the Commission's orders in connection with the ISO Tariff, as initially filed, treated the operation of the ISO Controlled Grid as an inseparable adjunct to the ISO's Control Area responsibilities.²¹ Given these facts, an interpretation of the ISO Tariff that excluded *one*

²⁰ *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 *Fed. Reg.* 21,540 (1996), *FERC Stats. and Regs.*, ¶31,036 at 31,716, and n. 385 (1996), *order on reh'g*, Order No. 888-A, 62 *Fed. Reg.* 12,274 (1997), *FERC Stats and Regs.*, ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part, remanded in part on other grounds sub nom., Transmission Access Policy Study Group, et al. v. FERC*, 225 F. 3d 667, Nos. 97-1715 *et al.* (D.C. Cir.), *aff'd*, *New York v. FERC*, 535 U.S. 1 (2002).

²¹ For example, the Commission insisted that the ISO have the discretion to determine, based on its *Control Area* responsibilities, which facilities of the Participating Transmission Owners would be included in the ISO

(. . . continued)

Scheduling Coordinator from the obligation to pay a fair share of the Ancillary Service costs the ISO incurs because of the loads reflected in the ISO's Schedules would produce results that would indeed be "unfair, unusual, absurd, or improbable."

The *May 10 Order* approval of an exemption for off-ISO Controlled Grid loads from the obligation to share in Ancillary Service Costs creates inappropriate and inefficient incentives for PG&E. By shielding PG&E from the Ancillary Services costs associated with its COTP Schedules, it eliminates any incentive for PG&E to ensure that Ancillary Services to cover the COTP loads are self-provided in accordance with its contracts with COTP participants. Even worse, it eliminates any incentive for PG&E to notify the ISO if any Ancillary Service capacity have been self-provided to cover the COTP loads, let alone to ensure that the capacity has been made available to the ISO in accordance with its standards for Ancillary Services. Knowing that the ISO must procure those Ancillary Services anyway, and that PG&E will not be charged, PG&E could simply sell any self-provided Ancillary Services into the ISO markets, pocketing the proceeds. The *May 10 Order* gives no consideration to the illogical results and inappropriate incentives that its flawed approach to cost allocation creates.

5. The ISO's Ancillary Service Costs Should Be Allocated To the Scheduling Coordinators on Whose Behalf It Procures the Ancillary Services.

The Commission declined to consider whether its exclusion of the off-ISO Controlled Grid loads in PG&E's COTP Schedules is consistent with cost causation principles, with the conclusory statement that the ISO had not shown any tariff or equitable right to assess the charges. *May 10 Order* at P. 33. This bare statement is insufficient to satisfy the Commission's

Controlled Grid. *Pacific Gas & Electric Co.*, 77 FERC ¶ 61,204 at 61,822 (1996). *See also*, *Pacific Gas and Elec. Co.*, 81 FERC ¶ 61,122 at 61,456-57, 61,496, and 61,499 (1997).

obligations to demonstrate that it engaged in reasoned decision-making and to spell out the basis for its decisions.

Well-settled Commission and judicial precedent is clear that each customer's charges should reflect the costs of serving that particular customer and the benefits the customer derives from the services provided. *See, e.g., Western Mass. Elec. Co.*, 66 FERC ¶ 61,167 (1994), *aff'd Western Mass. Elec. Co. v. FERC*, 165 F.3d 922 (D.C. Cir. 1999); *Seminole Electric Cooperative, Inc.*, 46 FERC ¶ 61,119, at 61,470-71 (1989). As discussed above, the evidence before the arbitrator leaves no doubt that the ISO must take into account all loads in its Control Area – including off-ISO Controlled Grid loads – in procuring Ancillary Services if it is to satisfy WECC MORC requirements, as the ISO Tariff requires it to do. Moreover, the Commission has recognized the authority of the ISO to meet its Control Area obligations and to impose charges related to those obligations. *See, e.g., California Indep. Sys. Oper. Corp.*, 103 FERC ¶ 61,114 (2003). There is no question that the ISO's compliance with WECC reliability requirements through its procurement of Ancillary Services benefits all Scheduling Coordinators in its Control Area, including PG&E. Fidelity to accepted cost causation principles dictates that PG&E should bear its proportionate share of the ISO's Ancillary Services costs. The *May 10 Order* contains no explanation or justification for the Commission's deviation from these principles in this instance.

In fact there is no valid reason for failing to apply cost causation principles to require PG&E to pay a share of the ISO's Ancillary Service costs associated with the COTP loads in its Schedules. Since the beginning of the ISO's operations, PG&E and the COTP Participants have enjoyed the benefits of the reliability that is achieved through the ISO's operation of its Control Area in conformance with WECC requirements. A portion of the Ancillary Services procured by

the ISO would not have been required but for the off-ISO Controlled Grid loads in the Schedules submitted by PG&E (and PG&E's failure to adhere to the ISO Tariff's provisions for self-supplied Ancillary Services). PG&E and the COTP Participants it represents through those Schedules caused the ISO to incur those costs and directly benefited from the ISO's services. Consistent with the principle of cost causation, the Scheduling Coordinator responsible for the submission of those schedules should bear the costs thereby imposed, and if there is any ambiguity in the Tariff, it should be resolved in favor of that result.

VI. CONDITIONAL MOTION FOR STAY

Under Section 13.4.4 of the ISO Tariff:

Implementation of the award [of an arbitrator following alternative dispute resolution] shall be deemed stayed pending an appeal unless and until, at the request of a party, the FERC or the court of competent jurisdiction to which an appeal has been filed, issues an order dissolving, shortening, or extending such stay.

Although the Commission denied the ISO's appeal of the arbitrator's decision in the *May 10 Order*, no party requested that the Commission dissolve the automatic stay that took effect under Section 13.4.4, and the Commission did not dissolve or mention the stay in the *May 10 Order*. Accordingly, by the express terms of the ISO Tariff, the arbitrator's award requiring the ISO to reimburse PG&E \$14,172,337.08, plus interest for Ancillary Services procured by the ISO and paid for by PG&E between March 31, 1998 and April 30, 1999, remains stayed. It is accordingly unnecessary for the ISO to seek a stay of the *May 10 Order*.

Out of an abundance of caution, if the Commission disagrees that the automatic stay imposed by Section 13.4.4 remains in effect, the ISO requests that the Commission reinstate the stay pending the Commission's disposition of the ISO's Motion for Clarification and Request for

Rehearing. Continuation of the stay of the arbitrator's award is necessary in the interests of justice.

As discussed in the ISO's Motion for Clarification (Section IV, above) and Request for Rehearing (Section V(A), above), ambiguities in the *May 10 Order* create uncertainty regarding the ISO's authority and responsibility to procure Ancillary Services to comply with its obligations under the ISO Tariff and the WECC's requirements. That uncertainty infects the ability of the ISO to implement the arbitrator's award in accordance with the procedures specified in the ISO Tariff.

Section 13.5 of the ISO Tariff governs the disposition of an arbitrator's award following alternative dispute resolution under the ISO Tariff. Section 13.5.1 provides that, if the ISO must pay an award to a party, it "will recover the amount payable from Market Participants and Scheduling Coordinators." Section 13.5.2 directs the ISO to "calculate the amounts payable to and receivable from the party, Market Participants, and Scheduling Coordinators, as soon as reasonably practical, and shall show any required adjustments as a debit or a credit in a subsequent Preliminary Settlement Statement."²² Section 13.5.3 contains two methods for allocating the costs of an award among Market Participants. The preferred method is set forth in Section 13.5.3.1, which states that "[t]he ISO will use best efforts to determine which Market Participant(s) is or are responsible for and/or benefit from payment of an award by or to the ISO and to allocate receipt of or payment for the award equitably to such Market Participant(s)." If those Market Participants cannot be identified, Section 13.5.2.1 of the Tariff requires that "[a]ny awards for which the ISO is unable to identify Market Participants in accordance with 13.5.3.1

²² Section 13.5.2 also provides that, as an alternative, an amount payable by the ISO to a party may be credited to the party "as soon as the ISO and the party may agree."

and any award amounts that the ISO is unable to collect that are not covered by Section 11.16.1 will be allocated to all Scheduling Coordinators through Neutrality Adjustments.”

The ambiguity created by the Commission’s *May 10 Order* with respect to the ISO’s authority to procure Ancillary Services to meet its Control Area obligations with respect to off-ISO Controlled Grid, makes it difficult, if not impossible, for the ISO to identify the beneficiaries of the Ancillary Services procured by the ISO during the period covered by the arbitrator’s award, as required by Section 13.5.2.1. The difficulty is compounded by the bankruptcy of some of the ISO’s major Market Participants, including PG&E, following that period.

If the automatic stay imposed by Section 13.4.4 were deemed to have been dissolved, the present situation would meet the applicable standards for a stay of the *May 10 Order*. The Commission may stay its action “when justice so requires.” 5 U.S.C. § 705. In deciding whether a stay would be appropriate in a particular case, the Commission generally considers several factors: (1) whether the moving party will suffer irreparable injury without a stay; (2) whether issuing a stay will not substantially harm other parties; and (3) whether a stay is in the public interest. *CMS Midland, Inc. v. Midland Cogeneration Venture Limited Partnership*, 56 FERC ¶ 61,177, at p. 61,631 (1991), *aff’d sub nom. Michigan Municipal Cooperative Group v. FERC*, 990 F.2d 1377 (D.C.Cir.), *cert. denied*, 510 U.S. 990 (1993).

In this case, the ISO and Market Participants would be irreparably injured if the ISO were precluded from allocating responsibility for reimbursement to PG&E to the Market Participants who benefited from the Ancillary Services procured by the ISO, rather than to all Scheduling Coordinators through Neutrality Adjustments. PG&E, in contrast, is not injured by waiting for payment until the Commission clarifies the *May 10 Order*, since the credit to its Settlement Statement will include interest in accordance with the Arbitrator’s order. *AAA Order* at p. 21.

The public interest will also be served both by the allocation of responsibility for the award to Market Participants who benefited and by the most expeditious clarification of the ISO's responsibility for determining the quantities of Ancillary Services required to maintain the reliability of the ISO Controlled Grid and to meet its obligations as a Control Area operator.

VII. CONCLUSION

WHEREFORE, the ISO respectfully requests clarification and rehearing and, to the extent necessary, a stay, as discussed above.

Respectfully submitted,

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Dated: June 9, 2004

CERTIFICATE OF SERVICE

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

Dated at Folsom, CA, on this 9th day of June, 2004.

/s/ Stephen A.S. Morrison
Stephen A.S. Morrison