

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

California Independent System Operator Corporation)	Docket No. ER04-835-000
)	
Pacific Gas and Electric Company)	
)	
v.)	
)	
California Independent System Operator Corporation)	Docket No. EL04-103-000 (consolidated)
)	

**BRIEF ON EXCEPTIONS OF THE
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

<p>Charles F. Robinson Anthony J. Ivancovich Geeta Tholan California Independent System Operator Corporation 151 Blue Ravine Road Folsom, California 95630 (916) 608-7135</p>	<p>Kenneth J. Jaffe Michael E. Ward Alston & Bird LLP 601 Pennsylvania Ave., NW North Building, 10th Floor Washington, D.C. 20004 (202) 756-3300</p>
---	---

November 30, 2005

TABLE OF CONTENTS

	<u>Page</u>
Table of Contents	i
I. Exception	1
II. Background.....	1
III. Policy Considerations Warranting Review.....	6
IV. Argument	7
V. Conclusion	10

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

California Independent System Operator Corporation)	Docket No. ER04-835-000
)	
Pacific Gas and Electric Company)	
)	
v.)	
)	
California Independent System Operator Corporation)	Docket No. EL04-103-000 (consolidated)

Pursuant to Rule 711 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.711, the California Independent System Operator Corporation (“ISO”)¹ respectfully submits its Brief On Exceptions.

I. EXCEPTION

The ISO makes the following Exception to the Initial Decision:

1. The Initial Decision incorrectly concluded that the ISO lacks the authority to deny a waiver of the must-offer obligation based on an anticipated lack of sufficient Ancillary Services capacity to meet reserve requirements.

II. BACKGROUND

This proceeding concerns Amendment No. 60 to the ISO Tariff, which made a number of revisions to ISO Tariff provisions concerning the must-offer obligation. The

¹ Capitalized terms not otherwise defined are used in the sense given in the Master Definitions Supplement, ISO Tariff Appendix A.

Commission imposed the must-offer obligation in 2001 “to ensure that all units that are able to run but are not already scheduled to run (with the exception of hydroelectric power . . .) are in fact made available to the ISO in the real-time market.” *San Diego Gas & Elec. Co. v. Sellers of Ancillary Services*, 95 FERC ¶ 61,115 at 61,357 (2001). Long Start Generators that request, and are denied, a waiver of the must-offer obligation are paid Minimum Load Cost compensation (“MLCC”). *California Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,022 at P 82 (2004). One aspect of Amendment No. 60 involved moving the criteria for granting waivers of the must-offer obligation from Section 5.11.6 of the ISO Tariff to a new Section 5.11.6.2 without making any substantive modifications to the existing provisions. Stated differently, in Amendment No. 60, the ISO did not propose any substantive modifications to the existing tariff criteria for granting waivers of the must-offer obligation. The Commission accepted that portion of Amendment No. 60 as just and reasonable and not unduly discriminatory. *See id.* at Ordering Paragraph (A).

The Initial Decision in this proceeding concerns the issue of the allocation of MLCC costs, which the Commission set for hearing. In Amendment No. 60, the ISO proposed to amend its Tariff to allocate the costs in three buckets, according to the nature of the reason for the denial of the waiver: local, zonal, or system. *See* Transmittal Letter for Amendment No. 60, Docket No. ER04-835-000 (May 11, 2004), at 31-36. The ISO set forth the criteria for assigning waiver denials to particular buckets in Attachment E in its transmittal letter for Amendment No. 60. Two of the criteria concern the allocation of MLCC costs when the ISO denied waivers because of an anticipated shortage of Ancillary Services. If the ISO were procuring Ancillary Services zonally at that time, the

MLCC costs would be allocated zonally; if the procurement were on a system basis, the allocation would be on a system basis.

Commission Trial Staff and the State Water Project challenged these criteria on the basis that the ISO lacked the authority to deny waivers because of a need for Ancillary Services. In its Initial Brief, the ISO first explained the manner in which waiver denials would assist the ISO to resolve the issues presented by potential Ancillary Services shortages. Under Section 5.11.1 of the ISO Tariff (Item by Reference 1, Sheet 184A), all Generators subject to the must-offer obligation must bid their available capacity into the ISO's real-time Energy market. As a result, those Generating Units would be online and available to provide Imbalance Energy to replace Operating Reserves (Ancillary Services) dispatched by the ISO pursuant to Section 2.5.22.9 of the ISO Tariff. Moreover, under Amendment No. 60, because Generators are able recover Minimum Load Cost Compensation costs if providing Ancillary Services from such units, the Generators have every incentive to bid those units into the ISO's Ancillary Service Markets. In addition, if necessary, the ISO may purchase Ancillary Services from such units under Section 2.5.22.1 of the ISO Tariff (Item by Reference 1, Sheet 99), if its Operating Reserves are depleted by the need to provide Imbalance Energy.

The ISO then explained that the appropriate question is not whether the ISO has the authority to deny a waiver because of a potential deficiency of Ancillary Services, but rather whether the ISO properly can even grant a waiver under such circumstances. Under Section 5.11.6 of the ISO Tariff (Item by Reference 1, Sheet 184C), Generators may seek a waiver of the must-offer requirement. Section 5.11.6.2 sets forth two primary criteria for the granting of such waivers, one of which is the need to meet Operating

Reserve requirements. Specifically, Section 5.11.6.2 states, *inter alia*, that “[t]he ISO shall grant waivers so as to: 1) provide sufficient on-line generating capacity to meet operating reserve requirements” Operating Reserves under the WECC Minimum Operating Reliability Criteria are the equivalent of the ISO’s Regulation, Spinning Reserves, and Non-Spinning Reserve Ancillary Services. Tr. 737 (Bodine). Operating Reserves are defined by the ISO Tariff as Spinning and Non-Spinning Reserves. Thus, Section 5.11.6.2 of the ISO Tariff (Item by Reference 1, Sheet 184F.02), expressly provides that the ISO should not grant, *i.e.*, it should deny, a waiver if it believes that it will have inadequate Ancillary Services.

The ISO explained that, to the extent the ISO is operating within the criteria of Section 5.11.6.2 in granting waivers, there are no tariff limitations on the reliability concerns that the ISO may take into account in determining which specific waiver requests to grant and which to deny. An anticipated lack of Ancillary Services bids is such a reliability concern.

On reply, the ISO elaborated on these arguments by citing the Commission’s earlier approval of Section 5.11.6, from which the criteria in Section 5.11.6.2 derived:²

The Commission’s April 26 Order set forth that the purpose of the Must-Offer Obligation is to ensure that all units that are able to run but are not already scheduled to run are made available to the ISO in the real-time market. The Must-Offer Obligation is designed to ensure that the ISO will be able to call upon available resources in the real-time market to the extent energy is needed. A generator that has available energy in real time should be willing to sell that energy since it has no alternative purchaser. Additionally, the Commission noted that the Must-Offer Obligation should provide the ISO adequate capacity to help meet operating

² The ISO’s Reply Brief stated that this was the Commission’s approval of section 11.6.2, a double typographical error: the order approved section 5.11.6, the criteria of which were, as noted, moved to section 5.11.6.2 in Amendment No. 60.

requirements.

In conditionally approving the ISO's proposed exemption procedures from the Must-Offer Obligation, the Commission intended to assist generators with long start-up times and high Minimum Load Costs and to provide flexibility to the ISO regarding the balancing of load and resources. Therefore, we find the ISO's proposal that exemptions will be granted so as to (1) provide sufficient on-line generating capacity to meet operating reserve requirements; and (2) to account for other physical operating constraints of generating units reasonable.

....

We agree with Reliant that the ISO must revise its Tariff to provide that a generator be informed that a waiver request has been accepted, denied, or revoked, including the reason(s) for the decision, which must be non-discriminatory. With respect to the ISO's Tariff provision that such exemptions be granted by the ISO at its sole discretion, we find this provision not unreasonable as such discretion is reviewable by the Commission. Generators can file complaints if they believe the ISO has used its discretion in an arbitrary or discriminatory manner. With respect to the intervenors concerns regarding transparency, we believe that with our required Tariff modifications, this requirement will be met.

San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.,
99 FERC ¶ 61,158 at 61,630 (2002) (footnotes omitted).

The Initial Decision found the three bucket allocation methodology just and reasonable, but found Amendment No. 60 unjust and unreasonable because the criteria for assigning waiver denials to particular buckets were not included in the tariff. It found, however, that an alternative with the three buckets and Attachment E included as part of the ISO Tariff would be the preferable just and reasonable alternative.

The Initial Decision also found, however, that the ISO lacked the authority to deny waivers because of an anticipated lack of Ancillary Services. The very abbreviated discussion can be reproduced in whole:

I find and conclude that ISO has “utterly” failed to establish that it has any authority whatsoever to commit must-offer generation to provide ancillary services. Despite ISO’s assertions, I find no such authority in the tariff.

ISO merely cites Amendment No. 60 itself, apparently taking the position that proposing to grant itself authority to commit must-offer generation to provide ancillary services actually confers that authority. Such claims merit no discussion. ISO should not be permitted to circumvent and expand the ancillary services market by abusing the must-offer obligation to force generators into a position where they have no rational choice but to offer into that market.

Initial Decision at P 138.

III. POLICY CONSIDERATIONS WARRANTING REVIEW

The legal and logical errors discussed herein, by themselves warrant Commission review. However, Commission review is particularly important because the Initial Decision could interfere with the ISO's ability to administer the must-offer obligation in the manner necessary to ensure the reliability of the Control Area Grid. As discussed herein, the Commission has recognized that one purpose of the must-offer obligation is to ensure that the ISO has adequate operating reserves. *San Diego Gas & Elec. Co.*, 99 FERC at 61,630.³ Spinning Reserves and Non-Spinning Reserves, two types of Ancillary Services, constitute the ISO's Operating Reserves as that term is defined in the ISO Tariff.⁴ To prevent the ISO from taking into account its need for Ancillary Services in its waiver denial decision would hamper significantly the ISO's ability to fulfill its responsibilities under the must-offer program and maintain grid reliability. The ISO believes that review of this portion of the Initial Decision is necessary to ensure that the

³ Another purpose of the must-offer obligation is to prevent physical withholding. *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.*, 99 FERC ¶ 61,159 at 61,640 (2002). Denying a must-offer waiver request so that a unit will be on-line in Real-Time if the ISO is anticipating a reserve shortage is consistent with this goal.

⁴ Under the WECC Minimum Operating Reliability Criteria Regulating Reserves are also considering Operating Reserves. Because of the specific requirements for the provision of Regulation, however, the ISO would not deny waivers because of an anticipated shortage of Regulation.

must-offer obligation continues to serve its purpose(s) until it is replaced as part of continuing market redesign.

IV. ARGUMENT

The conclusions in the Initial Decision are not legally, factually or logically supported. First, the Initial Decision finds no authority in the ISO Tariff for the ISO to commit must-offer generation to provide ancillary services. Presumably the Initial Decision intended to use “commit must-offer generation” in the sense it is used in Attachment E, *i.e.*, deny a request for a waiver of the must-offer obligation. The ISO only commits units to provide Ancillary Services through its Ancillary Services markets and has no authority to force Generating Units to bid into those markets through the must-offer process or otherwise. However, as discussed herein, the ISO does have the express authority in its Tariff to deny must-offer waivers if there will otherwise be insufficient “on-line generating capacity to meet operating reserve requirements.”

Subsequent to Amendment No. 60, Generating Units that are denied must-offer waivers may bid into the Ancillary Service markets and, if their bids are accepted, do not forfeit payment of MLCC costs. See *California Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,022 at PP 83, 87-88. The ISO could issue waiver denials in the reasonable expectation that most, if not all, of the Generating Units for which denials are issued will bid their uncommitted capacity into the Ancillary Services markets, thereby relieving the ISO’s anticipated shortage of Ancillary Services. This does not, however, change the ISO’s authority.

It is not surprising that the Initial Decision finds no explicit authority in the ISO Tariff for the ISO to deny waivers to must-offer generation to provide Ancillary Services.

There is no explicit authority in the ISO Tariff for the ISO to deny waivers for any particular reason. The simple reason is that Generators have no entitlement to waivers under specific circumstances. Under Section 5.11.6 of the ISO Tariff, as explicitly endorsed by the Commission, the grant of waivers is in the ISO's sole discretion, subject to Commission oversight. *See San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Services, et al.*, 99 FERC ¶ 61,658 at 61,630. The ISO does not need specific authority to decline to exercise its discretion, it only need act reasonably and state its reasons; the lack of explicit tariff authority to deny waivers therefore cannot provide a basis for a conclusion that the ISO may not deny waivers because of an anticipated shortage of Ancillary Services.

The Initial Decision's second contention is that the ISO's only argument is based on Amendment No. 60 itself, which the Initial Decision finds improper. The ISO does indeed rely upon the language of Section 5.11.6.2 of the ISO Tariff, which was included in Amendment No. 60. However, the substance of Section 5.11.6.2 predated Amendment No. 60; Amendment No. 60 merely transferred the language from Section 5.11.6 to Section 5.11.6.2. Accordingly, the ISO in fact was not relying upon Amendment No. 60, but on language approved by the Commission in 2002. *See id.* at 61,630.

In any event, Section 5.11.6.2 was approved by the Commission in the July 8, 2004 Order on Amendment No. 60; it was not set for hearing. *See California Indep. Sys. Operator Corp.*, 108 FERC ¶ 61,022 at Ordering Paragraph (A). There is thus nothing improper or illogical about reliance upon it. Finally, the Initial Decision asserts that denying waivers because of an anticipated shortage of Ancillary Services would constitute an abuse of the must-offer obligation, and "force generators into a position

where they have no rational choice but to offer into that market.” The Initial Decision ignores the fact, as discussed above, that the one of the fundamental purposes of the must-offer obligation is to ensure that the ISO has adequate Operating Reserves. The Initial Decision also ignores the fact that the must-offer obligation is by its nature a requirement; Generators have no choice but to bid into the ISO’s markets if they have available capacity (and the ISO has not granted them a waiver). Waivers provide Generators with an opportunity to avoid that obligation, but only when they may do so without endangering reliability of the Control Area grid. If the ISO finds it necessary to deny a waiver because of an anticipated shortage of Ancillary Services, the ISO is simply fulfilling its obligations in administering the must-offer obligation. Indeed, by allowing Generators to retain payments for Ancillary Services while operating under a must-offer waiver denial, Amendment 60 actually lessened the burden on Generators.

Issues pertaining to compensation for Must-Offer Generators were not set for hearing in this proceeding, and the resolution proposed by the Initial Decision could well interfere with the ISO’s ability to ensure adequate operating reserves.

V. CONCLUSION

WHEREFORE, the Commission should reject the Initial Decision's conclusion that the ISO lacks the authority to deny waiver from the must-offer obligation because of an anticipated shortage of Ancillary Services.

Respectfully Submitted,

Charles F. Robinson
General Counsel
Anthony J. Ivancovich
Assistant General Counsel
Geeta O. Tholan
Regulatory Counsel
California Independent System
Operator Corporation.
151 Blue Ravine Road
Folsom, CA 95650

/s/ Michael E. Ward
Kenneth G. Jaffe
Michael E. Ward
Alston & Bird LLP
601 Pennsylvania Ave., NW
North Building, 10th Floor
Washington, D.C. 20004
Tel: (202) 756-3300
Fax: (202)

Counsel for the California Independent
System Operator Corporation

Date: November 30, 2005

Certificate of Service

I hereby certify that I have this day served a copy of this document upon all parties listed on the official service list compiled by the Secretary in the above-captioned proceedings, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010). Dated this 30th day of November in the year 2005 at Folsom in the State of California.

/s/ Geeta Tholan
Geeta Tholan