

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

San Diego Gas & Electric Company,)	
)	
Complainant,)	
)	
v.)	Docket No. EL00-95-106
)	
Sellers of Energy and Ancillary Service Into)	
Markets Operated by the California)	
Independent System Operator Corporation)	
and the California Power Exchange,)	
)	
Respondents.)	
)	
)	
Investigation of Practices of the California)	Docket No. EL00-98-093
Independent System Operator and the)	
California Power Exchange)	
)	

**REPLY COMMENTS OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

Pursuant to the Commission’s Order on Rehearing issued on December 21, 2004¹, the California Independent System Operator (“ISO”)² provides the following response to the initial comments of the California Department of Water Resources State Water Project (“CDWR”).

¹ 109 FERC ¶ 61,306 (2004) (“December 21 Order”).

² Capitalized terms not otherwise defined herein shall have the meanings set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff.

I. REPLY COMMENTS

A. The Need For Outage Coordination is Premised on the ISO's Need to Ensure Reliable Operation of the ISO Controlled Grid

One of the major points that CDWR raises in its initial comments³ is that it requires reliable transmission service in order to fulfill its water management mission. CDWR suggests that rather than questioning how CDWR “can be forced to help remediate systemic California ISO failures,” the Commission should ask “whether the ISO . . . provides adequate transmission service to [CDWR].” CDWR’s point is a non-sequiter. Of course, the ISO believes that Market Participants on the ISO Controlled Grid expect and deserve reliable transmission service, and the ISO believes that it has met this goal under challenging circumstances.⁴ However, other than an irrelevant, and unsupported, comparison between ISO operations and operations under the previous vertically integrated system,⁵ CDWR does not explain how the ISO has failed to provide it, or any other Market Participant, with reliable transmission service. Moreover, CDWR’s comment relating to “systemic ISO failures”⁶ is just plain misleading. Although CDWR would apparently like to portray the ISO as the genesis of all the ills of the California energy marketplace, such is clearly not the case. Indeed, the ISO has made every effort over the past several years to respond to conditions largely beyond its

³ CDWR Initial Comments at 2.

⁴ CDWR’s suggestion that the ISO merely “dispatched and manages electrical power” is, of course, a gross oversimplification of the ISO’s responsibilities. CDWR Initial Comments at 2.

⁵ For this proposition, CDWR cites a FERC decision that says nothing concerning the quality of ISO transmission service to CDWR, or any other Market Participant. Unfortunately, such overstatements and mischaracterizations are legion in CDWR’s comments. Such inaccuracies are particularly ironic given CDWR’s charges concerning the ISO’s credibility.

⁶ CDWR Initial Comments at 4.

control, in order to ensure the reliability of the transmission grid entrusted to its oversight.

CDWR's argument is notable, however, in that it suggests a troubling belief that CDWR should be permitted to reap the benefits of participating in the ISO's Markets, but have little or no obligation to abide by rules designed for the common benefit of all Market Participants when such rules prove less than convenient to CDWR. Clearly, CDWR derives substantial benefit by virtue of its participation in the ISO Markets.⁷ However, in order for all Market Participants to realize these benefits, certain obligations and responsibilities are unavoidable. The ISO has demonstrated, and the Commission has agreed, that one of these obligations is the need for systemic coordination of Outage scheduling among all Participating Generators. Thus, it should be CDWR's burden to show how CDWR operations have been harmed to any degree, but certainly to such a degree that it requires an exemption from the ISO's Outage coordination authority, rather than the ISO's burden to show why CDWR should share the same responsibility as all other Participating Generators in this regard.

The ISO does agree with CDWR that, with respect to the issue of Outage coordination, reliability is a key issue. As the ISO has explained throughout the course of this proceeding, the primary reason behind the ISO's need for the ability to coordinate Outage schedules is, and has always been, to further the ISO's mission of ensuring the reliability of the ISO Controlled Grid for the benefit of *all* Market Participants. And reliability was the reason that the Commission, at the behest of its Staff's express recommendations, approved the ISO's authority to coordinate the Outage schedules of

⁷ See Management of the State Water Project, Bulletin 132-02 at 156 (January 2004) (showing revenues earned by CDWR for sales of energy into ISO markets).

Participating Generators. As the ISO explained in its initial comments, and in the affidavit of its Manager of Outage Coordination, Mr. Gregory VanPelt, conditions on the ISO Controlled Grid continue to present significant challenges to the ISO's mission of ensuring the reliable operation thereof.⁸ The ISO also explained that its ability to coordinate the Outage schedules of all Participating Generators is, and will continue to be, a crucial tool in meeting these challenges.

Nevertheless, as evident in its comments, CDWR continues to misapprehend, or misrepresent, the nature of the ISO's Outage coordination authority. It is the Participating Generator that creates and provides the ISO its Outage schedules in the first instance, and the Participating Generator may submit changes to its schedule. See ISO Tariff Section 2.3.3.5, Outage Coordination Protocol ("OCP") 2.2.1. The Tariff also allows for scheduling an Outage as little as 72 hours before the event. ISO Tariff Sections 2.3.3.3, OCP 2.2.1.1.⁹ Under Tariff sections 2.3.3.5.2 and 2.3.3.5.3, the ISO must approve the Outage unless it is likely to have a detrimental effect on the efficient use and reliable operation of the ISO Controlled Grid; see *also* ISO Tariff §§ OCP 2.2.3, 2.2.4.¹⁰ Once the Outage is approved, the ISO can cancel the Outage only if necessary to maintain System Reliability. ISO Tariff § OCP 4.3.9.

⁸ VanPelt Affidavit at 6-7.

⁹ Under the revised terms of the ISO Tariff as filed on May 11, 2001, the notice period would have been 120 hours. The Commission rejected that provision of the tariff amendment in its order of October 23, 2001. *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs. into Markets Operated by the Cal. Power Exch. and the Cal. Indep. Sys. Operator*, 97 FERC ¶ 61,066 (2001) ("October 23 Order") at 61,356.

¹⁰ Under the revised terms of the ISO Tariff as filed on May 11, 2001, the ISO could also reject an Outage schedule if the Outage would cause an unduly significant market impact. The Commission also rejected that provision of the tariff in its order of October 23, 2001. October 23 Order at 61,356.

B. CDWR's Claims With Respect to the ISO's Credibility Are Inaccurate

CDWR alleges that the ISO has “undermined its credibility by providing inaccurate claims about CDWR operations while offering no evidence that any outage control over CDWR has been needed.” CDWR Initial Comments at 4. CDWR first points to the discussion concerning its Hyatt-Thermalito facility in the ISO's request for rehearing of the Commission's June 22, 2004 Order on Remand, 107 FERC ¶ 61,294 (2004) (“Order on Remand”). Prior to filing its request for rehearing of the Order on Remand, the ISO solicited and obtained additional information from CDWR personnel concerning the operation of the Hyatt-Thermalito facility and its role in the California aqueduct system. Once the ISO became aware that it had filed incomplete information, the ISO promptly filed with the Commission a pleading correcting the record.¹¹ This does not, however, demonstrate a lack of credibility on the part of the ISO. Quite the contrary, the ISO's timely action to correct the record when it discovered that the information provided by CDWR was incomplete points to the opposite conclusion. What these events instead indicate is that, as with any Market Participant, the ISO's knowledge of CDWR operations is largely dependent on the information that it receives from CDWR personnel. If CDWR personnel provide the ISO with incomplete, or even inaccurate information, then the ISO will very likely be left with an incomplete, or erroneous, understanding of the manner in which CDWR operates. The ISO maintains that CDWR's energies would be better spent on attempting to improve communications with ISO personnel, rather than attempting to impugn the ISO's credibility.

¹¹ Clarification of Request for Rehearing of the California Independent System Operator Corporation, Docket Nos. EL00-95-085, *et al.* (August 5, 2004). Of course, as the ISO explained in its correction to its request for rehearing, the inaccurate information on the Hyatt-Thermalito facility did not undermine its basic point. *Id.* at 4.

The other “evidence” that CDWR offers in support of its allegations concerning the ISO’s credibility is the ISO’s “startling omission” of the fact that CDWR has, “as feasible and consistent with its primary water management obligations,” supported the ISO’s efforts to maintain grid reliability. CDWR Initial Comments at 5-6. Of course, the ISO applauds CDWR for its efforts to support grid reliability during the challenges of the past several years, as it does with respect to all of the numerous Market Participants who have done likewise. Certainly, CDWR cannot claim to be unique in this regard, and the ISO fails to see how CDWR’s argument is relevant to the issue at hand, other than to further demonstrate the fact that the ISO confronts significant challenges in maintaining grid reliability, such that tools like the comprehensive Outage coordination are essential in its ability to fulfill this mission.

CDWR also claims that the ISO has failed to cite to any reliability problems relating to the ISO’s lack of Outage control over CDWR facilities. CDWR misses the point again here in several respects. The issue is not merely whether the inability to coordinate CDWR’s Outages has caused, or would cause, a reliability failure on the ISO Controlled Grid.¹² The reliability problems that resulted from the ISO’s lack of authority to coordinate Outages were not due to the inability to coordinate the Outages of one, or several Participating Generators, but the absence of authority to coordinate outages on a *system-wide basis*. As the Commission recognized, it is systemic coordination that is crucial. Given that the ISO has shown, and the Commission has found¹³, that it is necessary for the ISO to have systemic authority to coordinate Generator Outages on

¹² It should be noted, however, that the ISO has, in its request for rehearing and initial comments, demonstrated that it is possible that the loss of coordination authority over the capacity controlled by CDWR could directly lead to reliability problems given tight demand conditions on the ISO Controlled Grid.

¹³ San Diego Gas & Electric Co., et al., 95 FERC ¶ 61,115 (2001) at 61,355.

the ISO Controlled Grid, it should be CDWR's burden to demonstrate that it requires an exemption from that authority, not the ISO's burden to show that its authority should apply to each individual Participating Generator separately. Indeed, if the ISO's Outage coordination authority was limited to only those units that it could discretely show contributed to reliability problems in the past, then that authority would be rendered meaningless.

C. CDWR Provides No New Evidence That It Requires an Exemption from ISO Outage Coordination Authority

CDWR provides nothing new in the way of argument or evidence in its initial comments to demonstrate that its operations are sufficiently unique so as to justify an exemption from the ISO's Outage coordination authority. Or, as the 9th Circuit framed the issue, whether the differences between CDWR and merchant generators "are material for purposes of outage control." Instead, CDWR devotes several pages to re-explaining how its operations distinguish it from other Generating Units, in order to refute what it characterizes as the ISO's argument that CDWR is identical to other hydro generators. However, the ISO has never made such an argument. The ISO has never maintained that there is no difference between CDWR and any other hydro generator. Indeed, even among hydroelectric generators that exist primarily to sell energy, each will undoubtedly possess some unique characteristics. What the ISO has argued, and what CDWR has yet to squarely address, much less refute, is that the ISO's Outage coordination requirements do not interfere with CDWR's water management responsibilities, and thus, it would be inappropriate to exempt CDWR from those requirements.

This contrasts sharply with the ISO's detailed explanation of how its Outage coordination authority is designed so as to specifically accommodate the individual needs and obligations of Market Participants such as CDWR. In its request for rehearing of the Order on Remand, and in its initial comments, the ISO explained that CDWR remains largely in control of its Outages because the ISO's Outage coordination procedures simply require Generating Units to submit their Outage schedules to the ISO and allows the ISO to modify those schedules only if the ISO determines that a modification is necessary to protect the reliability and efficient operation of the ISO Controlled Grid. Moreover, the ISO Tariff ensures that the ISO will not abuse its authority in connection with hydroelectric units, such as those operated by CDWR. In fact, the provisions of the ISO Tariff expressly prevent such a result. Section 2.2.1 of the ISO Tariff explicitly provides:

Nothing in this ISO Tariff is intended to permit or require the violation of Federal or California law concerning hydro-generation and Dispatch, including but not limited to fish release requirements, minimum and maximum dam reservoir levels for flood control purposes, and in-stream flow levels.

In its initial comments, the ISO also pointed out that the ISO Operating Protocol that relates to Outage Coordination directs the ISO, in prioritizing Outages, to take into account the special circumstances of operators such as CDWR. ISO Operating Procedure T-113 lists factors to be considered in prioritizing Outages to include "uncontrollable but predictable fuel . . . or water limitations," "regulatory or other legal constraints," "seasonal constraints," and "environmental benefits."¹⁴

¹⁴ Attachment C to ISO Initial Comments.

CDWR's only response to these facts is a baseless assertion that the ISO is not willing or able to implement these provisions. CDWR first claims that the ISO has "expressly eschewed responsibility for dispatching generation consistent with environmental and related concerns." In support, CDWR cites a pleading in which the ISO expressed its inability to know each environmental rule or applicable law relating to every Generating Unit on the ISO Controlled Grid, and thus made clear that it must be the responsibility of generators to bid in a manner consistent with applicable rules and regulations. But this passage says nothing about the ISO's willingness or ability to take such matters into account for purposes of Outage coordination. For instance, it is certainly true that a Participating Generator could deliberately schedule an outage so as to violate an applicable environmental restriction, and the ISO would likely not know this. In this respect, it is certainly true that it is incumbent on Participating Generators to schedule their Outages consistent with applicable rules and regulations. This, however, does not speak to whether the ISO is willing or able to take such matters into account when it coordinates the various Outage schedules submitted by Participating Generators, or considers whether canceling such outages is necessary in order to ensure grid reliability. Obviously, such a process must involve communication between the ISO and the Market Participant, and this is exactly the sort of process that the ISO follows in Outage planning. As the ISO explained in its initial comments, the ISO's willingness and ability to minimize changes to the Outage schedules submitted by CDWR is borne out by the results. With respect to a total of 746 CDWR Outages in the past 23 months, only 16 of these Outages were cancelled by the ISO, and of those, 14 were cancelled because they were scheduled as duplicate Outages. Thus, out of nearly

750 Outages scheduled by CDWR in the past two year period, only two have been cancelled pursuant to the ISO's Outage coordination authority.¹⁵

CDWR also maintains that "ISO operational personnel claim no familiarity with ISO Tariff provisions." CDWR at 10. In support, CDWR provides two transcripts. In neither of which does the ISO operator disclaim familiarity with the ISO Tariff. Instead, both operators state that they are familiar with the portions of the ISO Tariff that affect their particular job functions. Moreover, in direct contradiction to CDWR's unsupported suggestion that ISO Outage coordination personnel are unfamiliar with the ISO Tariff, the ISO's Manager of Outage Coordination, Mr. Gregory Van Pelt, testified directly to his familiarity with the sections of the ISO Tariff, protocols, and operating procedures, that pertain to Outage coordination, including the limitation set forth in Section 2.2.1. In addition, assuming *arguendo*, that any of these allegations were true, the applicable remedy would be to provide certain Tariff training to the ISO personnel involved not the exemption of CDWR from the Outage Coordination Protocol of the ISO.

D. The Commission Has the Authority to Direct the ISO to Coordinate Outages of All Participating Generating Units, Including Those Owned by CDWR

CDWR contends that because CDWR is a "public project," exempted from Commission regulation under the Federal Power Act, the Commission cannot subject CDWR to ISO Outage coordination authority. CDWR Initial Comments at 13-18.

CDWR has not sustained this argument, nor can it.

¹⁵ See Van Pelt Affidavit at 20. One of these Outages was rescheduled due to a conflicting transmission Outage, and one was cancelled due to it being scheduled on an ISO restricted maintenance day, which means that supply and demand were significantly tight on the ISO Controlled Grid.

The ISO does not dispute the principle that the Commission cannot directly regulate state and municipal entities, such as CDWR. The issue here, however, is not whether the Commission can directly regulate CDWR. Rather, the issue is whether the Commission can direct the ISO – a jurisdictional entity – to require in its tariff (which is applicable to both jurisdictional and nonjurisdictional generation owners that execute a PGA, a prerequisite to participation in the ISO’s Markets) that all Participating Generators submit their Outage schedules to the coordination of the ISO. The Court of Appeals for the D.C. Circuit, in *Northern California Power Agency v. FPC*, 514 F.2d 184 (D.C. Cir. 1975), cert. denied, 423 U.S. 863 (1975) – upon which CDWR relies – has laid out the path for analyzing an order to a jurisdictional utility that will impose obligations on a nonjurisdictional utility. In *Northern California Power Agency*, the court addressed a refusal by the Commission to impose a condition requested by a complainant on a contract for the sale of energy from a public utility to a municipality. The condition would have required that the municipality increase the capacity of a planned generating unit. The complainant asserted that, without the additional capacity, the contract would violate antitrust laws.

The court cited an earlier opinion in which it stated: “Where an agency has some regulatory jurisdiction over operations, it must consider whether there is a nexus between the matters subject to its surveillance and those under attack on anticompetitive grounds.” 514 F.2d at 188, (*quoting City of Lafayette, Louisiana v. SEC*, 454 F.2d 941 (1971)). Applying this principle, the court noted that the complainant had not asserted that the public utility’s rates – which were the matters subject to Commission jurisdiction – were discriminatory or unjust and unreasonable.

The complainant did not even allege that the public utility's rates were part of the anticompetitive activity complained of, which focused on the size of a generating unit planned by the nonjurisdictional purchaser. Accordingly, the Court concluded:

[W]e do not think that [the complainant] met its burden of showing a reasonable nexus between the alleged anticompetitive scheme of [the public utility] and the activities furthered by the . . . contracts filed as rate schedules. The "transaction" approved here consisted only of the rates that [the public utility] will be charging [the municipality]. While the consequences of approving the rate schedules could possibly further the alleged anticompetitive scheme, [the complainant] neither challenged the rates nor asserted their particular relevance to the alleged scheme.

Id. at 189.

The principle adopted in *Northern California Power Agency* – that the authority of the Commission to approve or direct a condition or rate term for a tariff of a jurisdictional entity, if that condition or term affects a nonjurisdictional entity, depends upon the relationship of the condition to the matter before the Commission – has guided judicial consideration of similar issues. For example, in *Altamont Gas Transmission Co. v. FERC*, 92 F.3d 1239 (D.C. Cir. 1996), cert. denied, 520 U.S. 1204 (1997), cited by CDWR, the Commission lowered the rate of return of a jurisdictional interstate pipeline and acknowledged that the purpose of its action was to pressure the state utility commission to change the rate of an affiliated nonjurisdictional intrastate pipeline. The court rejected the condition, concluding:

Although the Commission has broad authority to consider all relevant factors in deciding whether and upon what terms to issue a certificate, the rate structure of an affiliated [nonjurisdictional] pipeline is not a relevant factor.

92 F.3d at 1246.

Even more on point is *Pacific Gas and Electric Co. v. FERC*, 306 F.3d 1112 (D.C. Cir. 2002). Pacific Gas and Electric Co. presented the court with the question of the appropriate level of review by the Commission of the transmission revenue requirement of a nonjurisdictional municipal utility that had turned over control of its transmission facilities to the ISO (a “Participating Transmission Owner” or “PTO”). As the Court explained, the ISO compensates PTOs according to their transmission revenue requirements, which comprise the cost of the facilities and a rate of return. The ISO’s transmission rates in turn are based on the transmission revenue requirements of the PTOs. The Commission reviews the transmission revenue requirements of jurisdictional PTOs under a just and reasonable standard. *Pacific Gas and Elec. Co.*, 306 F.3d at 1114. Petitioners asserted that the Commission’s review of the transmission revenue requirement of a nonjurisdictional PTO (a municipality) under a lesser standard violated its obligations under the FPA. No party challenged the Commission’s jurisdiction to review the nonjurisdictional transmission revenue requirement. In remanding to the Commission for a better explanation of its methodology, however, the court affirmed that jurisdiction.

The Court noted that the Commission “uses its review of [the municipal’s transmission revenue requirement] to evaluate whether the [ISO’s] jurisdictional rates are permissible, a form of indirect regulation.” *Id.* at 1116. The Court concluded that the Commission was required to review the municipal’s transmission revenue requirement in order to determine whether the ISO’s rates were just and reasonable, but that the Commission’s orders were too vague regarding the standard to be applied. *Id.* at 1118-19.

In this case, the Commission's mandate that the ISO require Participating Generators to subject their Outage schedules to ISO coordination is directly and closely related to the Commission's performance of its most fundamental duty – to ensure that the jurisdictional rates for wholesale sales in the ISO's Markets are just and reasonable.

The Commission found:

[T]he electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and . . . , in conjunction with an imbalance of supply and demand in California, have caused . . . unjust and unreasonable rates [T]he California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA.

93 FERC ¶ 61,121 at 61,349-50, ER at 0035-36. The Commission concluded that Outage coordination and control of all Generating Units would “ensure that sufficient generation capacity is available to meet anticipated market needs,” *i.e.*, to prevent the tight supply that the Commission concluded gave rise to the opportunity for the exercise of market power. The Commission is not directly regulating CDWR, but simply conditioning its participating in the ISO's Market as necessary to ensure just and reasonable rates. The Commission's actions in this regard are not any different from its imposition of limits on the prices that sellers (including nonjurisdictional sellers) can charge for energy sold in the ISO's Markets, see, e.g., 95 FERC 61,115 at 61,358-59, ER at 0185-86, its requirement that nonjurisdictional utilities refund excess profits from the ISO's Markets attributable to the exercise of market power, whether by the nonjurisdictional utility or another entity (see *San Diego Gas & Elec. Co. v. Sellers of Ancillary Servs.*, 96 FERC ¶ 61,120 at 61,512-13 (2001)), or its requirement that nonjurisdictional entities that take service under a jurisdictional open access tariff

provide reciprocal open access, see Order No 888, supra, at 21,613-21,615. Such authority is critical to the Commission's mission. As the Commission stated in the context of other portions of its mitigation plan:

While the Commission does not directly regulate the non-public utility sales for resale . . . , we have the authority, and indeed the responsibility, to ensure that rates, terms and conditions for jurisdictional service are just and reasonable. However, the Commission cannot ensure such just and reasonable rates in the current circumstances . . . unless all entities that sell energy in the relevant spot markets or use the interstate transmission grid subject to our jurisdiction abide by the same conditions.

95 FERC 61,418 at 62,570, ER at 0240. It would be unduly discriminatory to have one set of Outage coordination guidelines that apply to jurisdictional generators participating in ISO Markets and a different set of Outage coordination guidelines for non-jurisdictional generators participating in the ISO's Markets. In this instance, the Commission was merely directing and authorizing the ISO to establish certain ground rules for all generators that participate in the ISO's Markets. The Commission's authority to determine the applicable terms and conditions of service for the provision of interstate transmission and sale of energy at wholesale by jurisdictional utilities is undeniable. For these reasons, the Commission has the jurisdiction to require that CDWR abide by the terms of the ISO Tariff and protocols as they concern the coordination of Outages through the ISO.

II. CONCLUSION

The ISO respectfully requests that the Commission accept these reply comments.

Respectfully submitted,

/s/ Gene L. Waas

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Dated: January 31, 2005



January 31, 2005

BY ELECTRONIC TRANSMISSION

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

**Re: San Diego Gas & Electric Co., et al.
Docket Nos. EL00-95-106
California Independent System Operator Corporation
And California Power Exchange
Docket Nos. EL00-98-093**

Dear Secretary Salas:

Enclosed for electronic filing please find Reply Comments of the California Independent System Operator Corporation in the above-referenced docket.

Thank you for your assistance in this matter.

Very truly yours,

/s/ Gene L. Waas
Gene L. Waas

Counsel for the California Independent
System Operator Corporation

Enclosures

cc: All parties of record

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 proceeding.

Dated at Folsom, CA, this 31st day of January, 2005.

/s/ Gene L. Waas
Gene L. Waas