UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))))	Docket No. ER99-3339-000

REQUEST FOR REHEARING
OF THE
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713, the California Independent System Operator Corporation ("ISO") submits this Request for Rehearing of the order issued by the Commission in the above-captioned docket on September 15, 1999 (the "September 15 Order" or the "Order") in which the Commission rejected *in toto* the proposed amendments setting forth the ISO's New Generator Interconnection Policy ("NewGen policy").[1]

I. SUMMARY

Currently, the specific terms of interconnections to the ISO Controlled Grid[2] are treated under the individual tariffs of the Participating Transmission Owners. The NewGen policy would establish an ISO-wide policy for processing

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[1] *California Independent System Operator Corporation,* 88 FERC ¶ 61,221 (1999).

[2] Capitalized terms that are not defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

interconnection requests, specifying, among other things, how applicants would mitigate cost-related impacts of their interconnection that would otherwise be borne by other users. The NewGen policy is the product of a lengthy and intensive stakeholder process conducted over the year preceding the filing and represents a fair balancing of interests.

The NewGen policy first and foremost sends enhanced price signals to generators as to where to locate on the grid so as to avoid exacerbating local congestion that cannot be mitigated through competitive redispatch bids. It also offers sufficient certainty to the market to enable the greatest number of new merchant plants to be financed. Capacity reserve margins in California and elsewhere in the West are razor thin and diminishing further. It is accordingly critical that a NewGen policy be implemented without delay. For that reason, the ISO respectfully requests that the Commission act on this request as soon as possible.

The Commission rejected Amendment No. 19 citing a “single flaw” in the NewGen policy: the perceived lack of a viable redispatch payment option. The ISO agrees that under established Commission policies, a new entrant should be able to choose the lower of the cost of upgrades or cost-based (or competitive market-based) redispatch costs. The NewGen policy in fact provides this choice – and others – to new generators, although the ISO’s filing did not detail how the ISO’s approach to Congestion Management in the absence of competitive redispatch bids ensures this result. This Request for Rehearing explains that, where the supply of redispatch bids is not competitive, the ISO addresses the

Intra-Zonal Congestion by redispatching generation available to it under *cost-based* contracts with RMR Units, which ensures that the NewGen policy would not produce inflated prices for Intra-Zonal Congestion relief.

For that reason, the ISO believes the "single flaw" cited by the Commission in fact does not exist and the filing should be accepted. In the alternative, the ISO respectfully suggests that the Commission should accept the NewGen policy, without the offending option, allowing the policy to go into effect on the basis of the other options available to a new entrant. Either option will enable the ISO to implement its NewGen policy promptly – an outcome crucial to facilitating critically needed capacity additions in California.

II. INTRODUCTION

A. Amendment No. 19

On June 23, 1999, the ISO filed Amendment No. 19 to the ISO Tariff. Amendment No. 19 would modify the ISO Tariff to implement the NewGen policy approved by the ISO Board of Governors. The NewGen policy establishes unified procedures and requirements for processing requests for interconnection to the ISO Controlled Grid, as well as policies regarding the obligations of applicants to mitigate certain cost-related impacts of their interconnection that would otherwise be borne by other users.

The NewGen policy is the product of a lengthy and intensive stakeholder process conducted over the year preceding the filing, through which the ISO has been working with Market Participants to develop its policy concerning requirements for new generators requesting interconnection to the ISO

Controlled Grid and existing generators that seek to increase their capacity. The purpose of the ISO's NewGen policy is both to send enhanced price signals to generators as to where to locate on the grid and to provide a certain level of price certainty so that generators can obtain necessary financing for their plants.

It is important to address these concerns without delay. Reserves are thin in California and throughout the West. New generation cannot be added without time for siting and licensing review and appropriate assurances to support merchant plant financing. Further delay presents the very real possibility that supplies will be inadequate to meet peak loads.[3]

The ISO and stakeholders focused their efforts on the issue of whether, and the extent to which, new or repowered generators would be responsible for mitigating the incremental Intra-Zonal Congestion created by their interconnection to the ISO Controlled Grid. The ISO has been advised by a number of generators that the resolution of this issue is a critical one for financing.

Under the NewGen policy, incremental Intra-Zonal Congestion attributable to the interconnection of a new or modified generator would be handled using the ISO's existing Intra-Zonal Congestion Management protocols, unless the

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[3] In a report on this situation issued earlier this year, the staff of the California Energy Commission ("CEC") observed:

> Reserve margins on peak are thin enough in California and the Southwest so that a dry hydro year or outages of any large unit or transmission line in California or the rest of the WSCC could seriously threaten system reliability. . . . As each year goes by without an increase in new generation capacity in California, the probability of Stage II alerts during the summer peak demand period will increase.

following circumstances are present: (1) the required System Impact and Facility Studies demonstrate that the requested interconnection will cause a significant increase in Intra-Zonal Congestion (*e.g.*, if the increased flow on the overloaded element is greater than five percent (5%) of the element's rating), and (2) the incremental Congestion cannot otherwise be mitigated through the use of competitive Adjustment Bids or Supplemental Energy bids. The new or modified generator may mitigate the incremental Intra-Zonal Congestion through a number of means described in proposed Tariff section 5.7.2.3.5, including providing financial support for a system expansion that eliminates the incremental Congestion. In addition, if the new or modified generator supports a system expansion, it will receive the associated System Benefits to the extent that it provides benefits that exceed the expansion needed to mitigate the new or modified generator's incremental Intra-Zonal Congestion, including, if applicable, Firm Transmission Rights and explicit recognition of any cost savings resulting from the deferral of transmission expansions planned by a Participating Transmission Owner.

B. The September 15 Order

The September 15 Order noted that the NewGen policy had broad, *albeit* not unanimous, support among stakeholders. (Slip op. at 7.) The Order also found that it was consistent with the Commission's transmission pricing policy to charge a new firm transmission customer the incremental grid cost for redispatch or expansion, whichever is less, as the NewGen policy proposed to do. (*Id.*at 8.)

High Temperatures & Electricity Demand: An Assessment of Supply Adequacy in California: Trends & Outlook, at 62 (July 1999). This report may be found on and downloaded from the

The Commission stated that, inasmuch as the NewGen proposal resulted from a stakeholder process, the Commission "would entertain the proposed policy," were it not for a single flaw that the Commission found in it. (*Id.* at 9.)

The flaw identified in the September 15 Order concerned one of the mitigation options the NewGen proposal would make available to new or modified generators assigned responsibility to mitigate incremental Intra-Zonal Congestion costs. Such generators could, among other things, enter into agreements with existing generators to curtail their generation when necessary to avoid Intra-Zonal Congestion.[4] The September 15 Order found that, when there are few existing generators who could reduce their output to relieve the incremental congestion caused by the new generator, the existing generators could demand excessive prices for redispatch. This would produce artificially high prices for congestion costs and therefore an inflated price against which the option of transmission expansion would be judged. (*Id.* at 8.)

II. SPECIFICATIONS OF ERROR

In compliance with Rule 713(c)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.7(c)(1), the ISO respectfully submits that the Commission erred in the following respects in the September 15 Order:

CEC's home page at < www.energy.ca.gov/electricity/1999-07-23 HEAT RPT.PDF>.

[4] Other options open to a new or modified generator to which the NewGen policy would assign responsibility for congestion costs are: (1) paying for a system expansion necessary to eliminate the incremental congestion; (2) committing to pay the ISO's costs of alleviating the incremental congestion through redispatch, (3) committing to reduce its own generation to alleviate incremental congestion, (4) paying for a Remedial Action Scheme (RAS) that would permit effective increase in the transfer capability of the path, and (5) choosing to locate its facility in another location, where it would not cause congestion that could not be mitigated through competitive redispatch.

1. The Commission erred in rejecting Amendment No. 19 on unfounded concerns that it would give existing generators the opportunity to command inflated prices for redispatch; and

2. The Commission erred in rejecting Amendment No. 19 in its entirety on the basis of a defect, that even if it existed, affects only one of six mitigation options available to new generators.

IV. ARGUMENT

A. The NewGen Policy Does Not Promote Inefficient Pricing for Intra-Zonal Congestion Relief.

As noted above, the September 15 Order did not find the NewGen policy to be conceptually flawed or contrary to the Commission's transmission pricing policy.[5] To the contrary, the Commission stated that, but for a "single flaw," the Commission would entertain the NewGen proposal. (September 15 Order, slip op. at 9.)

This "single flaw" involves one of six options allowed a new entrant – the choice to mitigate new Intra-Zonal Congestion it causes by entering into a bilateral contract with an existing generator in the "export zone" (the portion of a Zone where economic generation is locked in by an Intra-Zonal constraint) for that generator to back down its output when Congestion would otherwise be present. (*Id.*) The order noted that, when the new generator locates in an area

[5] Rather, the Commission confirmed that the Commission's transmission pricing model allows a new entrant to be charged the cost of expanding the transmission system to accommodate its service or the cost of redispatching generation for that purpose, whichever is higher. *See Pennsylvania Electric Co.,* 60 FERC ¶ 61,034 (1992), *aff'd*, 11 F.3d 207 (D.C. Cir. 1993). The NewGen policy is consistent with this pricing model.

where there is not a competitive supply of redispatch bids, “there will be insufficient competitive forces to discipline the payments the existing generators demand to back down.” (*Id.*) This would enable the existing generators to set an artificially high price for congestion relief, setting the wrong price for redispatch and therefore for transmission expansion. (*Id.*)

The ISO respectfully submits that this “single flaw” does not exist. Rather, the ISO’s procedures for managing Intra-Zonal Congestion in the absence of a competitive market for redispatch bids – which were not fully explained in the ISO’s initial filing -- mitigate the perceived opportunity for an existing generator to exercise market power if the bilateral contract option is selected.[6] The bilateral contract option is only one of the ways generation could be redispatched. New generators have another redispatch mitigation option: paying the ISO’s costs of redispatching generation to relieve the Intra-Zonal Congestion. As the ISO explained in its Answer submitted in this docket on August 11, 1999, the ISO’s procedures for managing Intra-Zonal Congestion already take account of the prospect that a competitive market for redispatch bids may not be available. In those circumstances, the ISO redispatches generation made available to it through cost-based RMR Contracts accepted by the Commission

[6] The Commission was correct in noting that under the ISO’s NewGen policy, a new generator will bear the costs of mitigating the incremental Intra-Zonal Congestion resulting from its interconnection only in instances where that Congestion cannot otherwise be mitigated through the use of competitive Adjustment Bids or Supplemental Energy bids. In the September 15 Order the Commission also correctly noted that, in those instances, it will be necessary for the new generator to weigh the cost of expansion against the cost of the other five identified mitigation options, including the cost of relieving the congestion through redispatch (as well as locating elsewhere where congestion is not as severe).

to relieve the congestion and thereby to maintain local reliability.[7] The NewGen policy permits a new or modified generator to satisfy its obligation to mitigate the cost of incremental Intra-Zonal Congestion by assuming the costs of the cost-based redispatch undertaken by the ISO.

Because a new or repowered generator can agree to bear the ISO's cost of redispatching generation under cost-based RMR Contracts, an existing generator cannot demand monopoly rents. Rather, there will be a market-based ISO redispatch cost or a cost-based RMR redispatch. The cost-based redispatch option thus disciplines the potential market power of existing generators – a fact that the Commission apparently had not understood from the ISO's filing.[8]

In other words, the September 15 Order's premise that the new generator is forced to "rely . . . on a market-based bid for redispatch where there is not a competitive supply of redispatch bids" is mistaken, in light of the effective cost-based upper bound on redispatch costs discussed above. (September 15 Order, slip op. at 8.). The Commission's conclusion that the NewGen policy would enable an existing generator to command inflated prices for redispatch is therefore unfounded. Because the "single flaw" that concerned the Commission is effectively addressed by other components of the NewGen policy, the Commission should accordingly grant rehearing to accept Amendment No. 19, as proposed.

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7 *See* ISO Operating Procedure M-401. A copy of this operating procedure is attached to this Request for Rehearing as Attachment A.

B. If the Commission Does Not Accept the NewGen Policy as Filed, It Should Permit the ISO To Implement the NewGen Policy, Modified To Exclude the Bilateral Negotiation Mitigation Option.

The September 15 Order stated that the Commission would entertain the NewGen policy, but for the "single flaw" that the Order identified with the bilateral negotiation mitigation option. (September 15 Order, slip op. at 8.) As shown above, that option in fact will not create opportunities for existing generators artificially to inflate congestion costs at the expense of new generators. Based on the existence of a constraining force that will prevent incumbent generators from artificially inflating congestion costs (*i.e.*, cost-based redispatch), the ISO believes that retention of the bilateral negotiation mitigation option is warranted.

However, if the Commission nevertheless remains convinced that incumbent generators could use the bilateral negotiation option to extract undue compensation in redispatch negotiations with new generators, the ISO respectfully suggests that the Commission should still accept the NewGen proposal, with the condition that the ISO exclude the bilateral negotiation mitigation option.

The September 15 Order found that the NewGen proposal was supported by a majority of stakeholders, from a cross-section of interest groups (as well as an overwhelming majority of the members of the ISO's Board of Governors), and, apart from the bilateral negotiation option, was consistent with the Commission's pricing policy in assigning to new customers the incremental costs of redispatch

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[8] The manner in which the cost-based redispatch option would operate to ensure that the costs of redispatch to relieve Intra-Zonal Congestion is illustrated in the example described in Attachment B.

or new construction necessary to accommodate their requested service. (*Id.* at 8.) In light of these findings, there is no basis to reject the NewGen proposal completely because of a supposed flaw in one mitigation option.

If the Commission is not persuaded to accept the NewGen policy as filed, it should accept it with the condition that the ISO remove the bilateral contract options. Such action is required

- to give effect to the efforts of the participants in the California market and other stakeholders to develop an approach that encourages the efficient addition of new generation without requiring other Market Participants to subsidize new generators, and
- to remove the uncertainty that is delaying the addition of new generation to address the tight supply situation in California.

Should the Commission continue to find fault with the negotiation option notwithstanding the ISO's clarification of the constraints that would apply to that option, proceeding in this manner would be consistent with the findings of the September 15 Order. It would avoid the need to ask stakeholders to reconsider issues that they have addressed over the past year and would enable them instead to focus their efforts on a more attainable objective: crafting a new bilateral mitigation option that addresses the Commission's objections.

V. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Commission grant rehearing of the September 15 Order to accept Amendment

No. 19 as filed. In the alternative, if the Commission is not willing to accept Amendment No. 19 as filed, the ISO respectfully requests that the Commission accept Amendment No. 19, modified to delete the option for a new generator to mitigate incremental Intra-Zonal Congestion costs through bilateral negotiations with an existing generator. In either event and in recognition of the substantial uncertainty facing new entrants and the effect it will have on delaying much needed generation projects, the ISO urges the Commission to act as soon as possible on the merits of this request.

Respectfully submitted,

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