

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

**California Independent System) Docket Nos. EL00-95-002
Operator Corporation) and EL00-98-002**

**ANSWER OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION
TO MOTIONS TO INTERVENE, COMMENTS, AND PROTESTS**

I. INTRODUCTION AND SUMMARY

On September 11, 2000, the California Independent System Operator Corporation (“ISO”)¹ filed Amendment No. 30 to the ISO Tariff.² Amendment No. 30 responded to the Commission directive in *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*,³ to “immediately institute a more forward approach to procuring the resources necessary to reliably operate the grid.”⁴ The ISO Tariff changes submitted in Amendment No. 30: (1) eliminate any potential ambiguity regarding the ISO’s authority to forward contract to meet the Load being served in the real-time

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

² Amendment No. 30 was originally assigned Docket No. ER00-3636-000. On October 5, 2000, the Commission cancelled that docket number and reassigned Amendment No. 30 to the above-captioned docket numbers.

³ *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 92 FERC ¶ 61,172 (2000) (“SDG&E Order”).

⁴ *Id.* at 61,608.

Imbalance Energy market, and (2) allocate the cost of any forward contracts to those who deviate in real time from their forward schedules.

Numerous parties have moved to intervene in the instant proceeding.⁵ Some of the motions to intervene include comments on or protests of Amendment No. 30, as well as requests for specific relief. Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure,⁶ the ISO submits this Answer to the motions to intervene, comments, and protests submitted in the above-captioned docket. As explained below, the ISO does not oppose the intervention of the parties that have sought leave to intervene in this proceeding. Rather, it seeks with this Answer to clarify those areas where confusion exists in the various motions, comments, and protests.

In particular, the ISO emphasizes that it filed Amendment No. 30 in direct response to the Commission's directive in the SDG&E Order. In this amendment, the ISO did precisely what the Commission asked it to do in its order, and no more. As it has stressed from the beginning, the ISO intends to keep its market activities to an absolute minimum. It has taken this limited

⁵ Some of the parties commenting on Amendment No. 30 do so in portions of their pleadings that are variously styled, without differentiation. Parties also request affirmative relief in pleadings styled as protests. There is no prohibition on the ISO's responding to the comments in these pleadings. The ISO is entitled to respond to these pleadings and requests notwithstanding the labels applied to them. *Florida Power & Light Co.*, 67 FERC ¶ 61,315 (1994). In the event that any portion of this Answer is deemed an Answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. § 385.213) to permit it to make this Answer. Good cause for this waiver exists here given the nature and complexity of this proceeding and the usefulness of this Answer in ensuring the development of a complete record. See, e.g., *Enron Corp.*, 78 FERC ¶ 61,179, at 61,733, 61,741 (1997); *El Paso Electric Co.*, 68 FERC ¶ 61,181, at 61,899 and n.57 (1994). Good cause also exists to allow the ISO to file this Answer one day out of time because it is early in the proceeding and no other party will be unduly prejudiced. The Commission has accepted an answer in such circumstances. *North Carolina Municipal Power Agency No. 1*, 40 FERC ¶ 61,138 (1987).

⁶ 18 C.F.R. § 385.213 (2000).

measure to comply with the Commission order and to ensure reliability. Moreover, the cost allocation method proposed in Amendment No. 30 is reasonable and is consistent with Commission precedent. The Commission has previously accepted the very same cost allocation methodology in analogous circumstances, so it should also be accepted here.

II. BACKGROUND

On August 23, 2000, the Commission issued the SDG&E Order, which initiated hearing proceedings to investigate the justness and reasonableness of rates of public utility sellers in the California ISO and Power Exchange (“PX”) Markets.⁷ In the SDG&E Order, the Commission “direct[ed] the ISO to immediately institute a more forward approach to procuring the resources necessary to reliably operate the grid.”⁸ On September 11, 2000, the ISO filed Amendment No. 30 to respond to the SDG&E Order by proposing two changes to the ISO Tariff. First, the ISO proposed to amend section 2.3.5.1.5 to eliminate any ambiguity regarding the ISO’s authority to contract without first soliciting bids. Second, the ISO proposed to amend section 2.3.5.1.8 to allocate the costs of any forward contracts to those Scheduling Coordinators who are responsible for incurring the costs, i.e., to those who deviate, in real time, from schedules, in

⁷ SDG&E Order, 92 FERC ¶ 61,172 (2000).

⁸ *Id.* at 61,607-08.

proportion to their deviations.⁹ The Secretary issued notice of the filing on September 13, 2000. Comments and protests were due on October 2, 2000.

Several parties filed motions to intervene, comments, and/or protests,¹⁰ and the Public Utilities Commission of the State of California (“CPUC”) filed a notice of intervention. The ISO now files this Answer to clarify the record on issues raised in those motions.

III. ANSWER TO COMMENTS AND PROTESTS

A. Amendment No. 30 Was A Direct Response To, And Was Limited To, The Commission’s Directive In The SDG&E Order.

In filing Amendment No. 30, the ISO was attempting to comply with the Commission’s directive to “immediately institute a more forward approach to procuring the resources necessary to reliably operate the grid.”¹¹ The proposed Tariff revisions in Amendment No. 30 are necessary for the ISO to implement a

⁹ Transmittal Letter for Amendment No. 30 filing at 2-3.

¹⁰ Motions to intervene, comments, and/or protests were filed by the Automated Power Exchange, Inc. (“APX”); California Department of Water Resources (“DWR”); California Electricity Oversight Board (“EOB”); California Power Exchange Corporation (“PX”); Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (“Southern Cities”); Cities of Redding, Santa Clara, and Palo Alto, California, and the M-S-R- Public Power Agency; City of San Diego; City of Vernon, California; Duke Energy North America, L.L.C., Duke Energy Trading and Marketing, L.L.C., and Duke Energy Merchants, L.L.C. (“Duke Energy”); Dynegy Power Marketing, Inc. (“Dynegy”); Metropolitan Water District of Southern California (“MWD”); Modesto Irrigation District; Morgan Stanley Capital Group Inc. (“Morgan Stanley”); Northern California Power Agency; Pacific Gas and Electric Company (“PG&E”); PPL Montana, LLC and PPL EnergyPlus, LLC (“PPL Parties”); Reliant Energy Power Generation, Inc.; Sacramento Municipal Utility District (“SMUD”); San Diego Gas & Electric Company (“SDG&E”); Southern California Edison Company (“SCE”); Southern Energy California, L.L.C., Southern Energy Potrero, L.L.C., and Southern Energy Delta, L.L.C. (“Southern Parties”); Transmission Agency of Northern California; Western Area Power Administration; Western Power Trading Forum (“WPTF”); and Williams Energy Marketing & Trading Company.

¹¹ SDG&E Order at 61,608.

more forward approach to procuring such resources.¹² They permit the ISO to address the Commission's concern regarding an "increasing level of market activity in the real-time market [that] raises significant reliability and economical concerns."¹³ If the ISO had not filed its Amendment No. 30 proposal, there might have been arguments that the ISO did not have the authority to forward contract beyond the Day-Ahead time frame and the allocation of the forward contract costs would not have been allocated to those who deviate in real time from their forward schedules. In addition, the ISO was mindful of the Commission's requirement that the ISO *immediately* institute a more forward approach to procuring resources. Amendment No. 30 was filed within three weeks of the issuance of the SDG&E Order.

While the ISO complied with the SDG&E Order, it did not overstep what the Commission required. As the ISO stated, "[i]t was intended that the ISO secure, on behalf of Scheduling Coordinators, only the necessary reliability services and very limited energy necessary to fine-tune the balance between supply and demand."¹⁴ Moreover, the ISO stated that it "continues to believe that its market activities should be constrained to an absolute minimum and that, most particularly, it should not be competing against Load-serving entities for the

¹² Transmittal Letter for Amendment No. 30 filing at 2. Additionally, in the transmittal letter for the Amendment No. 30 filing, the ISO noted that it "already has begun to explore the forward commitments that it may be able to place under contract." *Id.*

¹³ SDG&E Order at 61,607-08.

¹⁴ Transmittal Letter for Amendment No. 30 filing at 2.

energy needed to satisfy Load that is reasonably predictable.”¹⁵ In short, Amendment No. 30 is tailored to the requirements of the SDG&E Order.

Some parties argue that Amendment No. 30 does not comply exactly with the requirements of the SDG&E Order. For example, PPL Montana, LLC and PPL EnergyPlus, LLC (collectively, “PPL Parties”) state that the ISO has read the SDG&E Order too narrowly.¹⁶ They assert that the Commission did not outline a specific proposal that the ISO should submit; it “merely counseled that a forward approach to securing supplies should be embraced by the ISO.”¹⁷ While the Commission did not outline a specific proposal, it did not merely counsel the ISO in this regard. Rather, it directed the ISO to “immediately institute a more forward approach to procuring the resources necessary to reliably operate the grid.”¹⁸ The ISO followed this direction. PPL Parties also assert, among other things, that Amendment No. 30 deviates from Order No. 888 principles regarding ISO neutrality.¹⁹ The ISO reiterates that it continues to believe that its market activities should be constrained to an absolute minimum, that it only engages in contracts to support its responsibility to maintain system reliability, and that it should not be competing against Load-serving entities for the energy needed to satisfy Load that is reasonably predictable.²⁰ Its

¹⁵ *Id.*

¹⁶ PPL Parties’ Motion at 2.

¹⁷ *Id.*

¹⁸ SDG&E Order at 61,608.

¹⁹ PPL Parties’ Motion at 3.

²⁰ Transmittal Letter for Amendment No. 30 filing at 2.

examination of forward contract opportunities is conducted solely in response to the SDG&E Order. To the extent that PPL Parties believe that this violates any Order No. 888 principles, the argument should be taken up on rehearing of the SDG&E Order. It is not appropriate to make a collateral attack against the ISO for strict compliance with the Commission's orders.

Other intervenors also raise concerns that Amendment No. 30 has not matched the Commission orders. Duke Energy North America, L.L.C., Duke Energy Trading Marketing, L.L.C. and Duke Energy Merchants, L.L.C. (collectively, "Duke Energy") request that the Commission clarify that the ISO has not been directed to commence forward trading and that any future implementation of forward contracting should be conditioned upon, among other things, the development of standards and protocols.²¹ Southern California Edison Company ("SCE") states that Amendment No. 30 is replete with potential incentives for Load-serving entities to meet their demand in real-time, in contradiction of the Commission's direction in the SDG&E Order.²² Further, DWR states that Amendment No. 30 only addresses the ISO's ability to purchase energy in forward markets, and thereby, fails to address other problems that the Commission pointed out, such as the lack of mechanisms to promote demand response, underscheduling of generation and Load on the part of certain Scheduling Coordinators, and the ISO's need to purchase energy in real time markets to meet underscheduled Loads. The ISO is conscious of the concerns

²¹ Duke Energy Motion at 2.

²² SCE Motion at 8.

raised. However, Amendment No. 30 was not meant to be a comprehensive resolution of all issues confronting the ISO. On the contrary, it was meant to be a limited but immediate step toward ameliorating the reliance placed on real-time purchases of energy to meet Load.

As stated above, the amendment does two things to achieve that goal. First, it amends section 2.3.5.1.5 of the ISO Tariff to eliminate any potential ambiguity regarding the ISO's authority to contract without first soliciting bids. Second, it amends section 2.3.5.1.8 of the ISO Tariff to allocate costs of any forward contracts to those Scheduling Coordinators who are responsible for the incurrence of the costs – to those who deviate, in real-time, from schedules, in proportion to their deviations. Any remaining balance incurred by the ISO for the benefit of all market participants would be incrementally flowed through the neutrality clause in section 11.2.9 of the ISO Tariff.

As noted above, for those who argue Amendment No. 30 does not go far enough or does not address certain problems, Amendment No. 30 was not intended as a comprehensive solution. Rather, it was intended as a limited but immediate step towards addressing the amount of Load being served via the ISO's real time market. For others that argue the filing of Amendment No. 30 is itself an inappropriate action, this argument is nothing more than a request for rehearing of the San Diego Order. However, the only place in which a party could have properly made such an argument was as part of a request for rehearing of the SDG&E Order. A number of parties have submitted such

requests, and they should be considered in their correct place. The current proceeding is not the proper forum for a request for rehearing to be raised.

B. The Cost Allocation Method In Amendment No. 30 Is Reasonable and Is Consistent With Commission Precedent.

A number of parties raise concerns regarding the ISO's proposed cost allocation method. In particular, DWR asserts that Amendment No. 30 does not satisfactorily assign the cost of out-of-market ("OOM") forward purchases to the over-consumption of real-time energy. It states that the costs are not directly allocated to the Scheduling Coordinators responsible for incurring them.²³ The California Electricity Oversight Board expresses concern that the ISO's proposed cost allocation method creates economic incentives for suppliers not to bid into the Power Exchange ("PX") or to bid at a price higher than Load in the PX is willing to bear.²⁴ Morgan Stanley Capital Group Inc. asserts that the ISO fails to justify why its cost allocation first to the Scheduling Coordinators and then to all Market Participants is fair or prudent.²⁵ It also asserts that the ISO fails to explain how the aggregate cost of forward contracts will be allocated among individual Scheduling Coordinators.²⁶ Pacific Gas and Electric Company states that Amendment No. 30 does not address seller market power and could increase pricing leverage with the addition of the ISO as a buyer in the PX day-

²³ DWR Motion at 3.

²⁴ EOB Motion at 4.

²⁵ Morgan Stanley Motion at 5.

²⁶ *Id.* at 6.

ahead and other forward markets, making the proposed allocation of costs potentially inequitable.²⁷ Sacramento Municipal Utility District protests the notion that excess forward energy that is purchased because of a perceived need should be allocated to everyone.²⁸ PPL Parties assert that the amendment does not comply with the cost causation principle that costs should be paid by the parties that caused the costs to be incurred.²⁹ The Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (“Southern Cities”),³⁰ as well as Southern Energy California, L.L.C., Southern Energy Potrero, L.L.C. and Southern Energy Delta, L.L.C. (“Southern Parties”) also raise concerns regarding cost causation.³¹

Contrary to these allegations, the proposed cost allocation method is just and reasonable. It does conform to traditional cost causation principles, and the Commission has already accepted it in an analogous situation. As explained in the transmittal letter for Amendment No. 30, the proposed amendment would allocate the costs of any forward contracts to those Scheduling Coordinators who are responsible for the incurrence of the costs. In particular, it allocates the costs to those who deviate, in real-time, from schedules, in proportion to their deviations.³² Only in the unlikely circumstance that their allocation methodology

²⁷ PG&E Motion at 5.

²⁸ SMUD Motion at 4.

²⁹ PPL Parties Motion at 22.

³⁰ Southern Cities Motion at 7

³¹ Southern Parties Motion at 10-11.

³² Transmittal Letter for Amendment No. 30, at 3.

is not sufficient to make the ISO whole for the costs it incurs would costs be incrementally flowed through the neutrality clause in section 11.2.9 of the ISO Tariff as episodic charges incurred by the ISO for the benefit of all Market Participants.³³

This cost allocation method is consistent with that which the Commission accepted for Uninstructed Deviations and use of Replacement Reserves in the Commission's order on Amendment No. 14, which implemented Phase I of the ISO's comprehensive redesign of the Ancillary Services markets.³⁴ In Amendment No. 14, the ISO proposed, among other things, three related measures to create incentives for Scheduling Coordinators to submit schedules for supply and demand that more closely match actual, real-time transactions. First, the ISO proposed to procure extra Replacement Reserves to account for the difference between scheduled Load and the ISO's forecast Load, reduced by the additional supplies that the ISO expects to be available from other sources in real-time. Second, it proposed that the cost of extra Replacement Reserves would be borne by Scheduling Coordinators whose actual demands exceed scheduled demands or whose actual generation is less than scheduled generation. Third, it proposed that generators that fail to follow ISO instructions would have settlements determined at the "effective price," which is defined as

³³ *Id.*

³⁴ *AES Redondo Beach, L.L.C., et al.*, 87 FERC ¶ 61,208, at 61,810-11 (1999), *reh'g denied*, 90 FERC ¶ 61,036, at 61,177 (2000).

the average price paid or charged for real-time, Imbalance Energy paid to those units that followed dispatch instructions.³⁵

The Commission accepted the ISO's proposal to procure extra Replacement Reserves to meet unscheduled demand and overscheduled generation and to recover the costs from underscheduled Load and overscheduled generation.³⁶ In so doing, it noted that "[t]o the extent that the ISO must procure additional Replacement Reserves to meet unscheduled Load and to replace scheduled generation that is not produced in real-time, it is reasonable to charge the costs of these reserves to the Loads and generation that cause them."³⁷ The Commission also accepted the ISO's effective price proposal, stating that it would help to provide incentives for generators to follow ISO instructions by reducing the net compensation for failing to follow ISO instructions.³⁸

This is precisely what the ISO seeks to do with Amendment No. 30 – create incentives to follow ISO instructions and hold those who deviate accountable. Since the Commission has previously accepted the same cost allocation methodology, it should similarly accept the ISO proposal at issue here. As shown, the methodology follows traditional cost causation principles by allocating costs to those who caused them. Only if that allocation is not sufficient

³⁵ *Id.*

³⁶ *Id.*

³⁷ *AES Redondo Beach, L.L.C., et al.*, 87 FERC at 61,811.

³⁸ *Id.*

to make the ISO whole for the costs it incurs on behalf of all Market Participants will the ISO collect those costs through the neutrality clause. Thus, protests asserting any violation of cost causation principles are unsubstantiated and unfounded.

IV. CONCLUSION

WHEREFORE, for the reasons set forth above, the ISO urges the Commission to accept Amendment No. 30 without further proceedings.

Respectfully submitted,

Charles F. Robinson
General Counsel
Roger E. Smith
Senior Regulatory Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
(916) 608-7135
Telecopy: (916) 608-7296

Kenneth G. Jaffe
David B. Rubin
Christine F. Ericson
Bradley R. Miliauskas
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W.
Washington, D.C. 20007
(202) 424-7500
Telecopy: (202) 424-7643

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