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IVOR E. SAMSON (SBN 52767)
DONALD M. CARLEY (SBN 178889)
SONNENSCHN NATH & ROSENTHAL
685 Market Street, 6th Floor
San Francisco, California 94105
Telephone: (415) 882-5000
Facsimile: (415) 543-5472

Attorneys for Respondent and Counter-Claimant
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

AMERICAN ARBITRATION ASSOCIATION

PACIFIC GAS AND ELECTRIC COMPANY,

Claimant,

vs.

CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION,

Respondent.

CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION,

Counter-Claimant,

vs.

PACIFIC GAS AND ELECTRIC COMPANY,

Counter-Respondent.

Case No. 71 198 00711 00

**CALIFORNIA INDEPENDENT
SYSTEM OPERATOR
CORPORATION'S RESPONSE TO
CLAIM AND COUNTER-CLAIM**

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GENERAL DENIAL

1. The California Independent System Operator Corporation (“ISO”), the respondent and counter-claimant, denies that Pacific Gas and Electric Company (“PG&E”), the claimant and counter-respondent, has been damaged in the amounts alleged, or in any amount, or at all, as a result of the ISO’s actions or inactions, and denies that PG&E is entitled to any relief whatsoever as the result of any act or omission by the ISO. Moreover, the ISO expressly denies each of the allegations supporting the claim for damages of PG&E as set forth in PG&E’s Statement of Claim and subsequent Demand for Arbitration.

2. This response and counter-claim is filed without prejudice to ISO’s right to file an amended response, or request other or additional relief.

3. The ISO submits the following general response and counter-claim.

INTRODUCTION AND BACKGROUND

The ISO

4. The ISO is a California non-profit public benefit corporation established in 1997 to operate California’s transmission grid. The ISO commenced operations in or about March 1998, the ISO Operation Date, as part of California’s restructuring of the electricity industry.

5. The ISO is responsible for the operation and reliability of the transmission grid in California. As part of the restructuring of the California electricity industry, the ISO has assumed operational control of the transmission systems of the state’s investor-owned utilities -- PG&E, San Diego Gas & Electric Company (“SDG&E”), and Southern California Edison Company (“Edison”). These facilities constitute the “ISO Controlled Grid.” Under Section 201 of the Federal Power Act, 16 U.S.C. § 824, the ISO’s provision of transmission services is subject to the jurisdiction of, and regulated by, the Federal Energy Regulatory Commission (“FERC”). The ISO Tariff, which includes ISO Protocols and which the ISO has filed with FERC pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d, provides the rates, terms and conditions of the ISO’s services.

Ancillary Services

6. In order to ensure the reliability of the California transmission grid, the ISO must at all times have access to readily available reserve generating capacity, *i.e.*, Ancillary Services capacity, that it can call upon on short notice to address any energy imbalances. The term Ancillary Services is defined at Appendix A of the ISO Tariff as “Regulation, Spinning Reserve, Non-Spinning Reserve, Replacement Reserve, Voltage Support and Black Start together with such other interconnected operation services as the ISO may develop in cooperation with Market Participants to support the transmission of Energy from Generation resources to Loads while maintaining reliable operation of the ISO Controlled Grid in accordance with Good Utility Practice.”

7. The costs the ISO incurs to purchase Ancillary Services are passed on to the Scheduling Coordinator, which passes these costs onto other market participants and ultimately to the electric consumers they serve.

Scheduling Coordinators

8. Under the ISO Tariff, transmission transactions are arranged by “Scheduling Coordinators.” Under Appendix A of the ISO Tariff, a “Scheduling Coordinator” is broadly defined as “[a]n entity certified by the ISO for the purposes of undertaking the functions specified in Section 2.2.6 of the ISO Tariff [which sets forth the responsibilities of a Scheduling Coordinator].” In order to schedule transmission, Scheduling Coordinators must supply, or pay the ISO to supply, an amount of Ancillary Services capacity proportional to the magnitude of the demand served by their transactions.

9. PG&E has been certified by the ISO for the purpose of undertaking the responsibilities of a Scheduling Coordinator as set forth in Section 2.2.6 of the ISO Tariff.

10. The design of the ISO contemplates that each of the Participating Transmission Owners (“PTO”) -- such as PG&E -- will serve as the Scheduling Coordinator for the parties to any existing contracts. The ISO Tariff provides for Ancillary Services costs to be assessed on a PTO even though the economic arrangements under an existing contract might require other

1 parties (such as the California-Oregon Transmission Project) to bear the ultimate responsibility
2 for those costs.

3 **NATURE OF THE DISPUTE**

4 11. PG&E claims that the ISO cannot pass on costs to PG&E for Ancillary Services
5 provided for the benefit of the California-Oregon Transmission Project (“COTP”) and for the
6 Sacramento Municipal Utility District’s (“SMUD”) exports out of and imports into the Western
7 Area Power Administration (“WAPA”) system (commonly referred to as the “Bubble”).

8 12. The ISO properly passed on costs associated with the procurement of Ancillary
9 Services related to the COTP to PG&E. The ISO is responsible for reliable operation of the
10 entire control area (including non-ISO grid facilities) and must procure Ancillary Services to
11 meet the entire control area load. The Ancillary Services obligations may be satisfied by either
12 self-provision or by purchase from the ISO. Because the ISO obtained Ancillary Services for the
13 benefit of the COTP participants, the ISO is entitled to pass on costs, and PG&E is obligated to
14 pay for those services, as PG&E is the Scheduling Coordinator for the COTP.

15 13. Under the ISO Tariff, all transactions must be scheduled and settled by utilizing a
16 Scheduling Coordinator. The ISO Tariff provides that each of the Participating Transmission
17 Owners (like PG&E) will initially serve as the Scheduling Coordinator for the parties to existing
18 contracts. Costs for Ancillary Services procured by the ISO are assessed on the Participating
19 Transmission Owners under the ISO Tariff despite the fact that those costs may ultimately be
20 passed onto other parties.

21 14. PG&E is a PTO and its existing obligations and responsibilities with respect to the
22 COTP are specified in a Coordinated Operating Agreement (“COA”). The COA is an existing
23 agreement which must be honored by the ISO pursuant to the ISO Tariff. The COA requires that
24 the COTP participants must obtain, or self provide, Ancillary Services.

25 15. The COA entered into by the investor-owned utilities --PG&E, Edison and SDG&E --
26 as well as the participants in the COTP, is an existing contract that the ISO must honor. The
27 COA has not been terminated nor has it been assigned to the ISO.

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RELIEF REQUESTED

21. Based on the foregoing, Respondent and Counter-Claimant ISO seeks the following relief against Claimant and Counter-Respondent PG&E as follows:

- a. That PG&E take nothing on its claim;
- b. For damages in favor of the ISO for costs incurred to procure Ancillary Services with respect to the COPT from May 1, 2000 through August 31, 2000 in the amount of \$10,357,212.53, plus interest;
- c. For damages in favor of the ISO for costs incurred to procure Ancillary Services with respect to the COPT from September 1, 2000 to and including the date of the hearing in this matter, plus interest, according to proof at hearing;
- d. For a declaration that PG&E is responsible to ISO for payment of any future Ancillary Services incurred on behalf of the COTP participants in its capacity as COTP's Scheduling Coordinator;
- e. For a declaration that PG&E is required to continue to act as the Scheduling Coordinator for the COTP and provide the ISO with any scheduling information and data necessary to discharge its obligations under the ISO Tariff and ISO's obligation to safeguard the reliability of the California transmission grid.
- f. For attorney fees and costs associated with the defense of PG&E's claim and the filing and prosecution of this counter-claim; and
- g. For such other and further relief as may be deemed just and proper.

Dated: November 22, 2000

SONNENSCHN NATH & ROSENTHAL

By: _____
IVOR E. SAMSON

Attorney for Respondent and Counter-Claimant
CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

1 **REQUEST FOR SPECIFIC LOCALE**
2 **FOR HEARINGS AND ARBITRATION**

3 Pursuant to Section R-11 of the American Arbitration Association's Commercial Dispute
4 Resolution Procedures, Respondent and Counter-Claimant California Independent System
5 Operator hereby requests that any hearings and the arbitration in this matter be in San Francisco,
6 California.

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8 Dated: November 22, 2000

SONNENSCHN NATH & ROSENTHAL

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11 By: _____
12 IVOR E. SAMSON

13 Attorney for Respondent and Counter-Claimant
14 CALIFORNIA INDEPENDENT SYSTEM
15 OPERATOR CORPORATION
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SONNENSCHN NATH & ROSENTHAL
685 MARKET STREET, 6TH FLOOR
SONNENSCHN NATH & ROSENTHAL
685 MARKET STREET, 6TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 882-5000

27061122