UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

California Independent System Operator Corporation	Docket No. ER98-3760-000
Pacific Gas and Electric Company, San Diego Gas & Electric Company and Southern California Edison Company	Docket Nos. EC96-19-009 and ER96-1663-010
California Independent System Operator Corporation	Docket Nos. EC96-19-030 and ER96-1663-031

ORDER ON OUTSTANDING ISSUES RELATING TO THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

(Issued November 22, 2002)

1. In the proceeding to address outstanding issues relating to the California Independent System Operator Corporation (ISO),[1] approximately 100 issues remain unresolved at this time. This order addresses outstanding rehearing requests.[2] The requests for rehearing are granted in part and denied in part, as discussed in the body of the order. The order benefits customers by providing further clarity regarding the ISO Tariff and operation of the ISO markets.

Background

[1]Designated as Docket No. ER98-3760-000.

[2]Requests for rehearing of two Commission orders were identified in the outstanding issues proceeding. See Pacific Gas and Electric Company, et al., 81 FERC ¶ 61,122 (1997) (October 1997 order); California Independent System Operator Corporation, 83 FERC ¶ 61,209 (1998). Other remaining issues not addressed in this order will be addressed in future Commission orders and may be subject to further procedures.

2. On July 15, 1998, the ISO submitted a proposed "Clarification" amendment to the ISO's open access transmission tariff (ISO Tariff), which contained, among other things: (1) a clarification matrix listing numerous corrections and changes to its Tariff; and (2) a matrix listing 230 issues which were raised by intervenors in prior proceedings but remained unresolved or pending before the Commission. The ISO proposed a procedure to address issues that were raised, but not addressed, in connection with previous ISO filings.

3. In California Independent System Operator Corporation, 84 FERC ¶ 61,217 (1998), the Commission directed the ISO and the parties to develop a list of all active issues, to negotiate resolutions with respect to as many of these issues as possible, and to file a report with the Commission within 120 days of the date of the order containing a stipulation of outstanding issues that had been resolved through settlement, and issues that remain for resolution by the Commission.

4. On March 11, 1999, the ISO filed its "Outstanding Issues Report," which included a matrix of approximately 680 issues.[3] From this universe of issues, the report identified issues that had been resolved, issues that participants agreed were ripe for Commission resolution, and issues that the participants had not agreed to place in other categories. Further, the ISO report included procedural proposals agreed upon by the participants to (1) submit a settlement for resolved issues and (2) undertake to resolve the remaining issues.

5. In an April 28, 1999 order (April 28 order), the Commission accepted for filing the Outstanding Issues Report and established procedures to incorporate resolved issues into a settlement.[4] With regard to the remaining unresolved issues, the April 28 order directed

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[3]The outstanding issues had been raised in the following proceedings: October 1997 order, 81 FERC ¶ 61,122; Pacific Gas and Electric Company, et al., 81 FERC ¶ 61,320 (1997); California Independent System Operator Corporation, 82 FERC ¶ 61,312 (1998) (accepting ISO Tariff Amendment No. 1 with modification and rejecting Amendment Nos. 2 and 3); California Independent System Operator Corporation, 82 FERC ¶ 61,327 (1998) (accepting ISO Tariff Amendment Nos. 4, 5 and 6 with modification); California Independent System Operator Corporation, 83 FERC ¶ 61,209 (1998) (accepting ISO Tariff Amendment No. 7 with modification); ISO June 1, 1998 Compliance Filing in Docket Nos. EC96-19-029 and ER96-1663-030; and the ISO's clarification in Docket No. ER98-3760-000.

[4]California Independent System Operator Corporation, 87 FERC ¶ 61,102 (1999). The parties later submitted a partial settlement that was accepted by the Commission. See California Independent System Operator Corporation, 90 FERC ¶ 61,178 (2000) (letter

(continued...)

the ISO to file a Joint Statement of Issues identifying unresolved issues and identifying the proponents who advocate a change in the status quo for each issue. The order also established that, 24 days after the filing of the Joint Statement of Issues, Proponents and parties supporting Proponents' positions would file initial briefs on the unresolved issues, with answering briefs and reply briefs to follow.[5] To ensure an "orderly, efficient process," the Commission required that (1) the briefs follow the format of the Joint Statement of Issues; and (2) Proponents of each issue file a joint brief, with an opportunity to express diverging positions within the brief.

6. Proponents and other parties filed joint briefs on or before February 14, 2000. Answers were filed on or before April 10, 2000 and reply briefs were filed on or before May 8, 2000.

Procedural Matters

7. In the September 11, 1998 order, the Commission made clear that, while the identification of procedures for dealing with unresolved issues would be handled under Docket No. ER98-3760-000, none of the original underlying proceedings would be either reopened or terminated. Thus, for example, parties that failed to intervene in the original proceeding would not be given an opportunity to do so in the process of identifying and resolving outstanding issues.[6] In accord with the Commission's procedural determination, no new motions to intervene were filed.

8. Further, all joint briefs, answers and reply briefs were timely filed. Proponents and other parties briefing each particular issue are identified in the discussion of that issue.

Discussion

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[4](...continued)
order).

[5]In a subsequent order, the Commission allowed the Proponents and other parties additional time for filing initial briefs. California Independent System Operator Corporation, 90 FERC ¶ 61,051 (2000).

[6]See also 87 FERC ¶ 61,102 at 61,423.

1. With respect to ISO charges:[7]

a. Whether the Congestion Management and the Usage Charge components of the ISO Tariff's transmission pricing provisions are unjust and unreasonable (e.g., result in improper costs shifts and improper "and" pricing) not in conformance with the Commission's Transmission Pricing Policy?

9. Proponents, City and County of San Francisco (San Francisco), M-S-R Public Power Agency (M-S-R), the Cities of Santa Clara and Redding, California (Cities), City of Palo Alto, California (Palo Alto) and the Northern California Power Agency (NCPA), filed a joint brief on this issue, contending that the ISO Tariff's usage charge for inter-zonal congestion results in improper costs shifts and improper "and" pricing, and do not conform with the Commission's Transmission Pricing Policy Statement. As a remedy, they propose that the Commission direct the ISO to amend its congestion management program so that congestion revenues in excess of those necessary to pay the generators who relieve the congestion be credited back to the customers who incur those congestion charges through either a Firm Transmission Right (FTR) financial instrument or credit against transmission bills.

10. Southern California Edison Company (SoCal Edison), the Public Utilities Commission of the State of California (CPUC) and the ISO filed separate answers, and Proponents filed a joint reply brief.

Commission Response

11. The Commission previously addressed the issue raised by Proponents and concluded that the congestion usage charge neither results in "and" pricing nor is inconsistent with the

[7]The rehearing issues were identified in the Joint Statement of Issues under Subsection "O." Thus, Outstanding Issue O.1.a is address here as issue 1.a.

Commission's Transmission Pricing Policy Statement.[8] Thus, we deny the Proponents' request as seeking an improper rehearing of a rehearing.

1.b. Is the allocation of unaccounted for energy ("UFE") to wholesale transmission customers who have not signed Utility Distribution Company Agreements, unjust, unreasonable or unduly discriminatory?

12. Proponents, California Department of Water Resources (DWR), Metropolitan Water District of Southern California (MWD) and NCPA filed a joint brief arguing that the Commission erred in its finding that the ISO Tariff assignment of UFE losses to Scheduling Coordinators that deliver load at the transmission level is reasonable.[9] They contend that certain components of UFE, such as energy theft, statistical load profile errors and distribution loss deviations, are all directly attributable to distribution level loads. They argue that, because ISO Grid level loads do not contribute to these UFE components, they should not pay for them if principles of cost causation are to be followed in assessing ISO charges. However, they claim that the ISO does not allocate distribution-level UFE on the basis of cost causation, except for entities that have signed a Utility Distribution Company agreement with the ISO (which pay their own UFE calculated separately from their own meters). Rather, the ISO spreads the costs among Scheduling Coordinators, including those using only transmission-level service.

13. Proponents contend that the Commission accepted imposition of distribution-related UFE on wholesale transmission customers on the erroneous understanding that

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[8] See Pacific Gas and Electric Company, 80 FERC ¶ 61,128 at 61,429-30, order on rehearing, 81 FERC ¶ 61,122 at 61,476-78 (1997). See also the original pleadings filed regarding this issue: December 1, 1997 request for rehearing of Cities/M-S-R at 17-18, and December 1, 1997 request for rehearing of San Francisco at 6 ("in the October 30 Order, the Commission denies the requests for rehearing of the July 30 Order that were filed by San Francisco and others who contended that the congestion pricing component of the transmission pricing proposal, i.e., the Usage Charge, results in impermissible "and" pricing.").

[9] See October 1997 Order, 81 FERC ¶ 61,122 at 61,522. UFE is defined as the difference in Energy between the net Energy delivered into the Utility Distribution Company (UDC) Service Area (adjusted for UDC Service Area Transmission Losses) and the total metered Demand within the UDC Service Area (adjusted for distribution losses). Section 11.2.4.3 of the ISO Tariff provides that UFE will be allocated to each Scheduling Coordinator based on the ratio of its metered Demand within the relevant UDC Service Area to total metered Demand within the UDC Service Area.

"while the distribution loss deviation component should arguably not be assigned to such Scheduling Coordinators, the quantification of this single component may not be feasible."[10] They contend that the ISO is capable of identifying specific imbalances attributable to specific Scheduling Coordinators, noting that the ISO performs such quantification for entities that sign UDC agreements. Further, they argue that it is unduly discriminatory to allocate UFE based on cost causation to customers that sign UDC agreements, while entities such as DWR and MWD, which engage in no power distribution activities (and therefore are ineligible to enter into a UDC agreement), are ineligible to pay for UFE based on cost causation. As a remedy, they ask that the Commission direct the ISO to revise the Tariff to distinguish between distribution-level UFE and Grid-level UFE, and to charge its customers only for UFE shown to be associated with transmission on the ISO-Controlled Grid.

14. The ISO answers that Proponents' concerns have largely been ameliorated by improvements in the UFE methodology that better differentiate between transmission-level UFE and distribution-level UFE, and allocate UFE on the basis of cost causation. Thus, it states that only small amounts of distribution-level UFE costs are in the current UFE charges. Further, it claims that the ISO Tariff's method of allocating UFE based on UDC Service Area is reasonable, and not discriminatory as alleged by Proponents. It states that the ISO Tariff requires the ISO to calculate UFE charges separately for each UDC service area. Further, according to the ISO, the execution of a UDC Agreement regularizes and governs the relations between the ISO and the UDC, assigning to each a particular set of obligations and entitlements upon which the other party can rely. The ISO argues that allowing market participants to enjoy the benefits bestowed by the UDC Agreement without also taking on the obligations (as proposed by Proponents) would be unfair and discriminatory to market participants that have signed UDC Agreements.

15. Proponents reply that the fact that the ISO Tariff requires UFE calculation by UDC service area does not make it appropriate or foreclose consideration of superior alternatives. Further, they counter that the ISO, as a regulated monopoly, cannot deny captive customers just and reasonable rates to gain concessions from them in the form of a UDC agreement. Rather, they contend that all market participants with revenue-quality meters at ISO take points, and not just entities that have signed UDC agreements, should be allowed to pay their own UFE calculated separately with data from their own meters, and the ISO has not provided any reason for the different treatment. Further, they state that while the ISO's efforts to remove distribution-level UFE from ISO charges are commendable, it does not negate the need for a Tariff change to that effect.

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[10] Id., 81 FERC ¶ 61,122 at 61,522.

Commission Response

16. As noted by Proponents, the Commission's conditional acceptance of the UFE calculation proposal was based on the premise that the quantification of specific components of UFE "may not be feasible."[11] It appears that circumstances have changed. We previously accepted an ISO proposal to revise the ISO Tariff to change the method it uses to allocate UFE to UDCs from the system-wide allocation method to a method that utilizes actual transmission conductor loss values for individual UDCs.[12]

17. The ISO appears to acknowledge that more specific UFE cost assignment is feasible with regard to non-UDCs,[13] but argues that it is not reasonable to do so because of the ISO Tariff's method of allocating UFE based on UDC Service Area and because it would be unfair to entities that have signed UDC agreements. We disagree with the ISO's position that this is a matter of contractual entitlements and obligations. Rather, if market participants are incurring UFE charges for which they are not responsible, and the technology is available to more accurately account for the losses, the applicable Tariff provisions are unjust and unreasonable because they ignore principles of cost causation. Further, the fact that the ISO Tariff is based on UDC service areas should not prevent the more accurate assignment of UFE charges, as the ISO Tariff can (and should) be revised to reflect a fair and reasonable calculation of UFE charges.

18. Accordingly, we will grant rehearing and require the ISO to submit revised Tariff sheets to reflect that all market participants with revenue-quality meters at ISO take points should be allowed to pay their own UFE calculated separately with data from their own meters.

2. With respect to operating instructions:

a. Whether Section 2.4.4.4.1.1 of the ISO Tariff improperly provides for default to the Participating TO's operating

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[11] Id., 81 FERC ¶ 61,122 at 61,522.

[12] California Independent System Operator, 89 FERC ¶ 61,229 at 61,686 (1999), order on reh'g, 90 FERC ¶ 61,315 (2000).

[13] See ISO answer at 360-61.

instructions to the ISO for an Existing Contract when those instructions are disputed by the party or parties to the Existing Contract, and whether Sections 7.1.1, 7.3.1 and 7.4.1 of the Scheduling Protocol should provide for information regarding Existing Contracts to be set forth in the operating instructions to be developed jointly by the Responsible Participating Transmission Owner and the Existing Contract rights holder?

19. Section 2.4.4.4.1.1 of the ISO Tariff provides:

> The ISO shall have no role in interpreting Existing Contracts. The parties to an Existing Contract will, in the first instance, attempt jointly to agree on any operating instructions that will be submitted to the ISO. In the event that the parties to the Existing Contract cannot agree upon the operating instructions submitted by the parties to the Existing Contract, the dispute resolution provisions of the Existing Contract, if applicable, shall be used to resolve the dispute; provided that, until the dispute is resolved, and unless the Existing Contract specifies otherwise, the ISO shall implement the Participating Transmission Owner's operating instructions.

20. The October 1997 order accepted the provision, finding that it was reasonable for the ISO to rely on the operating instructions of the Participating Transmission Owner (Participating TO) as the entity most familiar with performing the operating instructions on a day-to-day basis under existing contracts. Further, the Commission found that the recommendation of Transmission Agency of Northern California (TANC) that disputed operating instructions should not be implemented until the dispute is resolved was "unworkable."[14] The Commission explained that the ISO must have "full and complete information, including all necessary operating instructions."

21. Proponents, TANC, Cities/M-S-R and Palo Alto, filed a joint brief arguing that Section 2.4.4.4.1.1 of the ISO Tariff is unfair and unreasonable because it vests inappropriate discretion in Participating TOs and creates no incentive for Participating TOs to move expeditiously to resolve disputes. They ask that the Commission direct the ISO to revise the provision to state that "until a dispute is resolved . . . the ISO shall . . . rely upon the prior operating procedures applicable to the Existing Contract." Proponents contend that this proposal would preserve the status quo, treat all parties fairly and provide the ISO with the "necessary operating instructions." They also contend that Existing Rights holders

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[14] See October 1997 Order, 81 FERC ¶ 61,122 at 61,473.

are excluded from the process of submitting instructions to the ISO for schedule validation, set forth in Sections 7.1.1, 7.3.1 and 7.4.1 of the ISO's Scheduling Protocol.

22. Further, Proponents claim that, if disputed instructions are implemented and the Commission later orders the instruction to be rescinded or modified, the Commission may not have the authority to award retroactive relief to aggrieved Existing Rights holders for damages incurred during a protracted dispute resolution process. To rectify this, they ask that the Commission direct the ISO to revise Section 2.4.4.5.4 of the ISO Tariff to provide that, in the event of an unresolved dispute, "parties shall have recourse to any legal remedies available to them . . . [and] the ISO shall discharge its responsibilities in a manner that honors the contractual rights and obligations of the parties to the Existing Contract . . ." They also ask for the deletion of language in that section which states that the ISO's ADR procedures are available to resolve disputes regarding, inter alia, the reasonableness of a Participating TO's operating procedures.[15]

23. The ISO answers that the challenged provisions are appropriate and necessary because, during the dispute resolution process, the ISO must continue to provide consistent service and the Participating TO is the party most familiar with performing the operating instructions under the Existing Contracts. It also contends that Proponents' alternative is not feasible. On this same point, SoCal Edison explains that Proponents have incorrectly assumed that there exists a set of written instructions that predate the ISO that could simply be handed to the ISO "and that such instructions, if they did exist, would not need to be adapted to function in the ISO market."[16]

24. Proponents reply that, consistent with the ISO's commitment to honor Existing Contracts, Existing Contract right holders should have a role in the development of operating instructions and their transmittal to the ISO. They also claim that municipal entities are intimately familiar with the operating instructions for their Existing Contracts and it is incorrect to assume that Participating TOs have superior knowledge of the such instructions. They also argue that their proposal – to continue use of the same instructions – is straight forward and workable.

Commission Response

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[15] Although not stated by the Proponents, this appears to be a rehearing request of the Commission's denial of protests that the ISO Tariff be clarified with respect to the use of the ISO ADR procedure and Existing Contracts. See id. at 61,473-74.

[16] SoCal Edison answer at 26.

25. The Commission reaffirms its conclusion that it is reasonable for the ISO to rely on the operating instructions of the Participating TO, and that Proponents' recommended revision to Section 2.4.4.4.1.1 is unworkable.[17] As explained by SoCal Edison, there may not be a written set of instructions to turn over to the ISO and, even if there were, they may need to be adapted to function in the ISO market. Further, simply turning over the disputed contract and any written instructions to the ISO for implementation is not feasible. If the contract and any related written instructions are subject to ambiguity so that the parties disagree over their interpretation, the ISO must then interpret the documents to determine the proper operating instructions until the dispute is resolved. However, as stated in the ISO Tariff, the ISO will have no role in interpreting Existing Contracts.

26. Further, we think that it is reasonable for the Participating TO to submit instructions to the ISO for schedule validation. To do otherwise would set up a situation where the ISO could receive conflicting instructions and thereby place the ISO in a position to be the arbitrator between the Participating TO and its customer. This is not, and should not, be the ISO's responsibility. Rather, parties should resort to the ADR procedures of the existing contract or the ISO Tariff to resolve their differences.

27. Finally, we reject Proponents' proposal to eliminate the ADR language of Section 2.4.4.5.4 and replace it with a statement that parties have recourse to any legal remedies available to them. Rather, the use of the ISO's ADR processes should be encouraged, and the restatement of parties' existing legal rights is unnecessary.

28. Accordingly, Proponents' request for rehearing on this matter is denied.

2.b. Whether the authority granted the ISO under its Tariff to control facilities of a Utility Distribution Company or Metered Subsystem is excessive and inconsistent with the terms and conditions of Existing Contracts, and whether the ISO's authority to approve or cancel outages, over metering standards and with respect to Operation & Management practices, which is different from or additional to the standards reflected in Existing Contracts, is unreasonable?

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[17] See October 1997 Order, 81 FERC ¶ 61,122 at 61,473.

29. TANC filed a brief arguing that numerous provisions of the ISO Tariff, ISO protocols and pro forma agreements relating to UDCs and Metered Subsystems (MSS) give the ISO excessive control over the facilities of those entities and are inconsistent, in many respects, with the terms and conditions of the Existing Contracts between the UDC/MSS and a Participating TO. It contends that the October 1997 order generally sanctioned the broad application of the ISO's authority over UDCs and MSSs and specifically rejected TANC's proposal to limit such authority to emergency conditions.[18] TANC asks that the Commission direct the ISO to eliminate conflicting provisions.

30. The ISO answers that TANC's argument is too vague because it fails to identify: (1) specific provisions of the Tariff or protocol; (2) the terms of Existing Contracts; and (3) the nature of the alleged conflict. Likewise, CPUC answers that TANC did not sufficiently explain the rationale for its request that ISO operating orders not apply to MSS/UDCs in certain circumstances. SoCal Edison states that the ISO filed revisions to the MSS-related provisions of the Tariff (Amendment No. 27) and contends that any remaining issues should be addressed in that proceeding.

31. In reply, TANC identifies sixteen Tariff provisions that are of concern. It also objects to deferring the issue to the Amendment No. 27 proceeding.

Commission Response

32. The October 1997 order found that "the requirement that participants comply with all ISO orders except those that would result in impairment to public health or safety to be reasonable," and explained that it is "essential" that participants follow such orders "since otherwise the ISO will be unable to effectively manage and control the ISO Controlled Grid."[19] Further, the Commission rejected TANC's proposal to revise the ISO Tariff to provide that the ISO's authority to control Ancillary Services provided by a MSS should exist only in emergency conditions. The Commission explained that the ISO, "as the single Control Area Operator, needs real-time dispatch rights over all resources committed to provide Ancillary Services."[20]

33. TANC does not offer any arguments to show why the Commission's above findings are in error. While it does claim that certain provisions of the ISO's Tariff and protocols conflict with Existing Contracts, it has not identified the Existing Contracts (much less the

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[18] Citing 81 FERC ¶ 61,122 at 61,456-57, 61,496-97 and 61,499-500.

[19] Id., 81 FERC ¶ 61,122 at 61,456-57

[20] Id., 81 FERC ¶ 61,122 at 61,496.

specific provisions) at issue or the nature of the supposed conflict. Thus, TANC has not provided sufficiently specific information upon which the Commission can rule. Accordingly, TANC's request for rehearing on this issue is denied.

2.c. Whether Section 2.3.1.2.1 of the ISO Tariff should be amended to limit the authority of the ISO to impose its operating orders on all Market Participants where no such authority derives from Existing Contracts or arrangements or where such orders are in direct conflict with the operating procedures of a Utility Distribution Company or the terms and conditions of an Existing Contract?

34. Section 2.3.1.2.1 of the ISO Tariff provides that:

> all Market Participants within the ISO Control Area shall comply fully and promptly with the ISO's operating orders, unless such operation would impair public health or safety. For this purpose ISO operating orders to shed Load shall not be considered as an impairment to public health or safety.

35. TANC, Cities/ M-S-R and Palo Alto filed a joint brief requesting that the Commission direct the ISO to revise Section 2.3.1.2.1 to limit the authority of the ISO to impose its operating orders on all Market Participants where such orders are in direct conflict with the operating procedures of a UDC or is inconsistent with the terms and conditions of an Existing Contract.[21] They argue that Section 2.3.1.2.1 is inconsistent with the Commission's ruling that existing rights under Existing Contracts must be preserved. They contend that the ISO's authority to administer an Existing Contract should be limited to the operating instructions submitted to the ISO by the Participating TO pursuant to Section 2.4.4.4.1.1.

36. The ISO answers that the revision is unnecessary because the ISO has committed to honor the terms of Existing Contracts. It states that the only exception to this commitment is where the ISO must issue instructions to maintain grid reliability. It explains that,

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[21]Proponents Initial Brief at 6-8. According to Proponents, TANC timely raised this issue but it was not addressed in the October 1997 order. In that same order, the Commission stated that "to the extent that the order does not address a proposed modification or a related nuance of an issue addressed in the order that is raised by a party, that proposal is deemed denied." 81 FERC ¶ 61,122 at 61,436. Thus, Proponents properly seek rehearing of this issue.

pursuant to Sections 5.1.3 and 5.6 of the ISO Tariff, the ISO can assume supervisory control over all generating units and system resources during a system emergency and in circumstances in which the ISO considers that a system emergency is imminent or threatened. It states that the Commission explained that these provisions are acceptable because "in an emergency, the ISO needs to be certain that its operating instructions will be followed."[22] CPUC characterizes Proponents' request as an attempt by holders of existing transmission contracts to avoid compliance with ISO rules.

37. Proponents reply that they are concerned about the application of "routine" operating orders to Existing Contracts. They agree that the ISO should be vested with full operating control in a system emergency or circumstances in which the ISO considers that a system emergency is imminent or threatened.

Commission Response

38. In its answer, the ISO represents that it has committed to honor the terms of Existing Contracts except where the ISO must issue instructions to maintain grid reliability, i.e., in the case of an emergency or circumstances in which the ISO considers that a system emergency is imminent or threatened. The ISO essentially argues that it is unnecessary to revise the Tariff because of its commitment. The Commission disagrees. Section 2.3.1.2.1 broadly indicates that Market Participants within the ISO Control Area must comply with the ISO's operating orders regardless of whether they conflict with the terms of Existing Contracts and regardless of grid conditions. Thus, we find that the provision is not just and reasonable. Accordingly, we direct the ISO to revise Section 2.3.1.2.1 to reflect its commitment and indicate an exception where an ISO operating order directly conflicts with the terms of an Existing Contract and there is no system emergency or circumstances in which the ISO considers that a system emergency is imminent or threatened. This change is necessary so that the provision will be just and reasonable.

39. This directive is consistent with the Commission's findings related to other Tariff sections. For example, the Commission found acceptable an ISO Tariff provision stating that the ISO had the right to use a UDC's load curtailment program with the clarification that it would only be utilized in emergency circumstances.[23]

40. Proponents, however, have not provided any rationale for their other proposed revisions to Section 2.3.1.2.1 relating to UDC operating procedures and the deletion of the

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[22] Citing October 1997 order, 81 FERC ¶ 61,122 at 61,571.

[23] Id., 81 FERC ¶ 61,122 at 61,512.

last sentence of the provision regarding operating orders to shed load. Accordingly, the Commission rejects Proponents' other proposed revisions.

3. Whether sections 2.3.1.2.2, 2.3.1.3.1, 5.1.1, and 5.6.1 should be revised to restrict the ISO's ability to give operational instructions to generation located outside of the ISO Control Area.

41. Cogeneration Association of California (CAC) and Energy Producers and Users Coalition (EPUC) request that the Commission find that the definition of ISO Control Area does not include qualifying facility (QF) generation so that ISO control is limited to QF generators that participate in the ISO ancillary service markets. The ISO answers that CAC/EPUC lack standing to raise the issue, have improperly broadened the scope of the issue originally raised by Bonneville Power authority (BPA) and are substantively incorrect. CAC/EPUC reply that the briefing process allows parties to reframe their positions in the context of the ISO's current operations.

Commission Response

42. CAC/EPUC's request is beyond the scope of BPA's original request for rehearing, regarding whether the Commission erred in accepting ISO Tariff provisions that would give the ISO control over generation not located in its control area. CAC/EPUC shift the issue to whether QF generation units are within the ISO's control area. This is not a situation where CUC/EPUC are reframing their position in the context of the ISO's current operations but, rather, is improperly using this forum as an opportunity to obtain a separate ruling on a different issue not raised before. Further, while the Commission indicated that parties would have some leeway to refocus issues in the context of the ISO's current operations, parties do not enjoy this same latitude with regard to issues on rehearing.[24]

4. Are ISO Tariff section 2.5.20.5.1 and SP sections 3.2.6.3, 3.2.8.3, and 3.3.1.3, which result in the invalidation of a submittal for all Settlement Periods for the relevant Trading Day if the submittal for any one Settlement Period is invalid, just and reasonable, and is Settlement and Billing Protocol 3.4, which provides that a Scheduling Coordinator error in the denomination of the reference number for an Existing Contract results in the entire Schedule being treated as a new

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[24] See, e.g., San Diego Gas & Electric Company, 99 FERC ¶ 61,160 at 61,649 (2002); Baltimore Gas and Electric Company, 92 FERC ¶ 61,043 at 61,114 (2000) (Commission looks with disfavor on parties raising new issues on rehearing).

firm use, consistent with the ISO Tariff's obligation to honor Existing Contracts as stated in sections 2.4.3 and 2.4.4?

43. Section 2.5.20.5.1 of the ISO Tariff, relating to the time-frame for informing the ISO of the self-provision of ancillary services, provides that "failure to submit the required information within the stated time frame for any hour shall lead to the self provision for all Settlement Periods of the relevant Trading day being declared invalid by the ISO, and under such circumstances the ISO shall purchase sufficient Ancillary Services to meet the Scheduling Coordinator's requirements to match its Day-Ahead Schedule." TANC, MWD, Southern Cities (consisting of Cities of Anaheim, Azusa, Banning, Colton and Riverside, California) and Dynegy Power Marketing, Inc. (Dynegy) filed a joint brief arguing that the invalidation of a schedule for an entire day due to an error in a single hour is not just and reasonable. They also contend that Section 2.5.20.5.1 (and related protocols) unreasonably exposes Existing Rights holders to additional costs that are not authorized under their Existing Contracts in a situation where a schedule for an Existing Contract is invalidated for the entire day due solely to Scheduling Coordinator error for one hour.

44. Proponents further contend that Section 3.4 of the Schedules and Bids Protocol (SBP), which provides that a Scheduling Coordinator error in the denomination of the reference number for an Existing Contract results in the schedule being treated as a new firm use (so that the Usage Charge applies), unreasonably exposes Existing Rights holders to extra-contractual costs. They note that, in a proceeding on a related issue, the ISO committed to honor Existing Contracts and to work with Existing Rights holders so that they may avoid usage charges.[25] Proponents understand this commitment to mean that the ISO will not invalidate Existing Contract schedules due to erroneous contract reference numbers and state that, if the ISO confirms this understanding as correct, they will not pursue their opposition to SBP 3.4.

45. The ISO answers that, due to software and "other" limitations, it can only deal with Day-Ahead Ancillary Services and Energy Schedules in full-day increments. It also states that, with regard to Existing Contracts, its software interprets an erroneous reference number as a new firm transmission request. It states that it has no basis on which to correct such reference numbers and that the burden to properly identify contracts is on the Scheduling Coordinator.[26] The ISO further states that Scheduling Coordinators should avail themselves of the validation procedure provided in Section 2.2.7.2 of the ISO Tariff, which allows Scheduling Coordinators to insulate themselves from the consequences of erroneous schedules.

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[25] Citing California Independent System Operator, 89 FERC ¶ 61,229 at 61,685.

[26] Citing California Independent System Operator, 83 FERC ¶ 61,209 at 61,922.

46. With regard to SBP 3.4, the ISO clarifies that the validation procedures should enable Scheduling Coordinators to protect Existing Rights from invalidation, however, it is the Scheduling Coordinator's responsibility to use these procedures to ensure such protections.

47. Proponents reply that the ISO should redesign its software so that schedules will be invalidated only for the hours in which an error occurs, and not the entire day.

Commission Response

48. We agree with Proponents that the ISO Tariff and protocols that require the invalidation of a schedule for the entire day due to an error in scheduling for one hour unduly penalize market participants for such an error and thus is not just and reasonable. The ISO's single justification for the provisions – that it must deal with Day-Ahead Ancillary Services and Energy Schedules in full-day increments due to software and "other" limitations – is inadequate. The ISO has not provided any details why it is not able to implement a software redesign to invalidate schedules only for specific hours in which an error has been identified. Nor does it explain what the "other" limitations might be. Accordingly, the Commission directs the ISO to revise Section 2.5.20.5.1 and related protocols to indicate that the failure to submit the required information for any hour shall lead to self-provision for that hour.

49. It appears that the ISO's representation with regard to SBF 3.4 is satisfactory to Proponents as they did not provide further comment on reply brief. Moreover, we agree with the ISO that Scheduling Coordinators should avail themselves of the validation procedures to protect Existing Rights holders. Accordingly, to the extent not withdrawn, we deny Proponents request for rehearing with regard to SBF 3.4.

5. Should ISO Tariff section 5.1.4 be modified to increase the size of the threshold exemption for Generating Unit compliance with section 5 (other than in System Emergencies)?

50. Section 5.1.4 of the ISO Tariff provides that a Participating Generator with a Generating Unit directly connected to a UDC system will be exempt from compliance with Section 5 of the ISO Tariff ("Relationship Between ISO and Generators"), other than in system emergencies, provided that (i) the output of the Generating Unit is less than 10 MW and (ii) the total output is sold to the interconnecting UDC or to customers connected to the UDC's system. MWD and Cities/ M-S-R filed a joint brief arguing that the exemption

should apply to larger units, suggesting 20 MW as the threshold amount.[27] They contend that this would be consistent with the increase in the minimum capacity standard from 10 MW to 20 MW recommended by the 2000 LARS (Local Area Reliability Service) process. Proponents argue that such a revision would allow small units that are Participating Generators to avoid costly upgrades in communications, telemetry and direct control equipment, required by Section 5 of the ISO Tariff. They also contend that an application of the exemption to larger units would encourage broader participation in ISO markets by smaller, local units since they could avoid the costly installation of Tariff-required instrumentation and equipment.

51. The ISO responds that the Commission should deny Proponents' request. It states that the communications and telemetry requirements are necessary for the ISO to determine its reserve responsibility and the current level of load being served; and that the calculations would become less precise if more generation units were exempted from providing the ISO with telemetry of their output. Further, it provides an estimate of the costs of such metering and communications and explains that while such costs typically do not present an undue burden, a case-specific exemption is available. The ISO also contends that the LARS process is inapposite since the minimum size of a unit to provide local area reliability does not diminish the ISO's need for accurate data from small units. SoCal Edison adds that the exemption of larger units would not significantly increase participation in the ISO markets since Section 5.1.4 only applies to generators that sell all of their output to the UDC that owns the UDC system to which they are interconnected or to the customers of such UDC. It states that the provision's application is limited to QF's since they typically sell their output to the UDC or interconnected customers.

52. Proponents reply that telemetry is not necessary because the ISO should be able to reasonably estimate the output of smaller units from recorded data and generator capabilities within the ISO's margin of error for forecasting loads and reserve requirements. Further, they challenge various aspect of the ISO's protocols for exempting units from the metering and communication requirements. They also agree that the LARS process is not directly related to the issue at hand but explain that they used the LARS criteria as an example of the ISO's "indiscriminate method of changing its requirements when it is less costly for the ISO."[28] Proponents disagree with SoCal Edison's argument,

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[27] According to the underlying requests for rehearing, this issue was raised by several parties but not addressed in the October 1997 order. As mentioned in fn. 21 above, the October 1997 order, 81 FERC ¶ 61,122 at 61,436, states that matters not addressed in the order are deemed denied.

[28] Proponents Reply Brief at 4.

arguing that the provision at issue benefits not only to QFs, but also hydro and distributed generation as well.

Commission Response

53. The Commission denies the request for rehearing on this issue. The ISO has articulated a reasonable rationale for limiting the exemption to units with an output of 10 MW or less – so that the ISO can accurately determine its load and reserve responsibility. Proponents have not provided any specific arguments or information demonstrating that the Commission erred or that the 10 MW limit for the exemption set forth in Section 5.1.4 is unjust or unreasonable. Proponents have not shown that the ISO can reasonably rely on estimates of all units under 20 MW (or some other higher threshold) to accurately calculate load and reserve. Further, owners of generation units that believe the metering and communication devices are too costly can seek a case-specific exemption to these particular requirements. Thus, Proponents' arguments do not negate the justness and reasonableness of the provision as proposed by the ISO.

6. Does ISO Tariff sections 5.2.7.1 and 5.2.7.2 require the unduly burdensome posting of financial security, thereby causing those Transmission Owners responsible for must-run payments to bear unnecessary costs?

54. No party filed a brief on this issue. Accordingly, this issue is dismissed.

7. Whether the protection afforded tax exempt debt should apply to debt issued after December 20, 1995?

55. Section 2.3.3 of the Transmission Control Agreement (TCA) states that nothing in the TCA "shall compel any Participating TO or Municipal Tax-Exempt TO which has issued Tax-Exempt Debt to violate restrictions applicable to transmission facilities financed with Tax-Exempt Debt or contractual restrictions and covenants regarding use of transmission facilities existing as of December 20, 1995." Cities/M-S-R and Palo Alto argue that the provision's restriction to facilities that were in existence as of December 20, 1995 is unduly discriminatory and is an impediment to tax-exempt entities joining the ISO.[29] They argue that entities should not have to choose between potential loss of their tax-exempt

[29] According to the underlying requests for rehearing, this issue was raised by several parties but not addressed in the October 1997 order. As mentioned in footnote 21 above, the October 1997 order, 81 FERC ¶ 61,122 at 61,436, states that matters not addressed in the order are deemed denied.

status and being unable to participate actively in the ISO. They state that, although the limitation in Section 2.3.3 reflects the limitation set forth in state law,[30] the Commission should not defer under the principle of comity but, rather, delete the provision to protect the benefits of tax-exempt status established by federal law, i.e., the Internal Revenue Code. Proponents are concerned that the provision has an immediate effect on M-S-R, which is partial owner of the Mead-Adelanto transmission project, which became operational on April 15, 1996. They believe that, if this project is not covered by the exemption, M-S-R's possible future membership in the ISO could endanger the tax-exempt status of the project.

56. The ISO answers that the California legislature, by mandating the provision, expressed a clear intent that the grandfathering of protection for certain tax-exempt financed facilities should have defined limits. It proposes interpreting the phrase "facilities existing as of December 20, 1995" to mean "existing but not necessarily in service as of December 20, 1995," so that the Mead-Adelanto project would be grandfathered.

57. Proponents reply that, while they appreciate and agree with the ISO's interpretation of the provision, their underlying concern remains, namely that municipal utilities may be hesitant to sign the TCA and join the ISO if the tax-exempt status of their future projects are endangered by excessive private use.

Commission Response

58. The Commission agrees with the Proponents that municipal entities should not have to choose between potential loss of their tax-exempt status and being unable to participate actively in the ISO. Accordingly, we grant rehearing on this issue and direct the ISO to delete from section 2.3.3. of the TCA the restriction "existing as of December 20, 1995."[31]

8. Whether the definitions of Regulatory Must Take Generation and Eligible Regulatory Must-Take Generation should be modified to ensure that all Must-Take units receive comparable treatment?

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[30] AB 1890 Section 12 (quoting California Public Utilities Code, Section 9600(a)(6)).

[31] We note that the Treasury Department recently issued final regulations governing the use of municipal utility facilities financed with tax-exempt bonds. Obligations of States and Political Subdivisions, 67 Fed. Reg. 59756 (September 23, 2002) (to be codified at 26 C.F.R. Part 1). Among other things, these regulations address the operation of such facilities by an ISO or regional transmission organization.

59. Cities/M-S-R and Palo Alto argue that the definitions of Regulatory Must Take Generation and Eligible Regulatory Must-Take Generation, set forth in Appendix A of the ISO Tariff, should be modified to ensure non-discriminatory treatment of the owners of generation. The ISO Tariff defines Regulatory Must-Take Generation as follows:

> "[t]hose Generation resources identified by CPUC, or a Local Regulatory Authority, the operation of which is not subject to competition. These resources will be scheduled by the relevant Scheduling Coordinator directly with the ISO on a must-take basis. Regulatory Must-Take Generation includes qualifying facility Generating Units as defined by federal law, nuclear units and pre-existing power purchase contracts with minimum energy take requirements.[32]

60. Eligible Regulatory Must-Take Generation is defined as follows:

> Regulatory Must-Take Generation which (i) has been approved as Regulatory Must-Take Generation by a Local Regulatory Authority within California, and (ii) is owned or produced by a Participating TO or UDC which has provided direct access to its End-Use Customers and serves load in the ISO Control Area.[33]

61. Proponents argue that certain benefits accrue to Eligible Must-Run Generation. They claim that, under Section 2.3.4 of the ISO Tariff, the ISO retains certain rights to reduce other Generation before Must-Take Generation to eliminate over-generation conditions. Proponents also point to section 5.1.5 of the ISO Tariff, which provides that the ISO will honor contractual rights relating to Regulatory Must-Take Generation. They then contend that, because of these benefits, the Commission must ensure that the criteria to qualify as Eligible Must-Run Generation must be just, reasonable and not unduly discriminatory.

62. Based on this premise, Proponents argue that the definition of Eligible Regulatory Must-Take Generation is "flawed" because it requires the owner of the unit to have provided direct access to end-use customers. Proponents state that they have the option under state law whether to open their systems to direct access. Therefore, they argue, if they choose not to open their systems to direct access, as allowed under state law, they should not be discriminatorily penalized under the ISO Tariff because their generation resources cannot

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[32] California ISO FERC Electric Tariff, First Replacement Vol. No. 1, Original Sheet No. 343, Effective October 13, 2000.

[33] Id., Original Sheet No. 312.

qualify as Eligible Regulatory Must-Take Generation. Further, the definition of Eligible Regulatory Must-Take Generation provides that the unit must be owned by an entity which "serves load in the ISO Control Area." Proponents contend that certain of their units and contracts do not qualify because, for example, M-S-R does not serve load directly but, rather serves load in the ISO Control Area through its members, Modesto, Santa Clara and Redding.

63. Proponents also argue that the definition of Regulatory Must-Take Generation is improperly limited to "pre-existing" contracts. They contend that Market Participants choosing in the future to enter into power purchase agreements with minimum-take provisions should not have to risk adverse treatment under the ISO Tariff. As a remedy, Proponents propose revisions to both definitions.

64. The ISO responds that Proponents are incorrect in their claim that generators enjoy certain benefits in terms of curtailment priority if they meet the definition of Regulatory Must-Take Generation and Eligible Regulatory Must-Take Generation. It states that Section 2.3.4 was revised so that the Overgeneration provisions no longer refer to Must-Take generation and that, while Section 5.1.5 refers to a general obligation to honor contractual rights, it does not confer any specific curtailment priorities. It also points out that Section 5.1.5 only mentions Regulatory Must-Take Generation and thus is irrelevant to Proponents arguments concerning Eligible Regulatory Must-Take Generation.

65. The ISO argues that there is no compelling policy reason to allow the Existing Contracts with minimum-take obligations identified by Proponents to be removed from the competitive market, which would be the result of Proponents' proposed expanded definition of Regulatory Must-Take Generation. It also claims that Proponents' proposal that the definition of Eligible Regulatory Must-Take Generation apply to future as well as pre-existing contracts is an unacceptable attempt to indefinitely shelter generation from market forces. CPUC argues that Proponents' proposal should be rejected as one-sided, and characterizes it as an attempt to avoid compliance with ISO rules.

66. Proponents reply that certain benefits remain under Section 5.1.5 respecting the discharge of the ISO's obligations under contracts related to Regulatory Must-Take Generation, and future Tariff changes may benefit such units. Further, while Proponents acknowledge that the contracts envisioned by the ISO for the special Regulatory Must-Take Generation treatment are limited to those facilities not subject to competition (such as nuclear and QF facilities), they argue that such treatment should nonetheless be expanded to include contracts and generators that would be penalized in the event of involuntary decreases in contract purchases or utilization of generation. They also reply that Regulatory Must-Take Generation should not be limited to pre-existing contracts because

contracts with minimum take provisions are traditional in the industry and their use should not be inhibited.

Commission Response

67. The Commission denies Proponents' request for rehearing on this issue, except on one point that they raise. First, Proponents have not identified any specific disparity in treatment in the over-generation context as alleged by Proponents. As noted by the ISO, revised Section 2.3.4 no longer makes reference to Must-Take generation. Proponents' claim that "certain benefits remain under Section 5.1.5" is nebulous. This section simply provides that the ISO will honor contractual rights and obligations, or final regulatory treatment, relating to Regulatory Must-Take Generation.

68. Second, one of the underlying goals of the creation of an ISO is the promotion of fair and efficient competition.[34] Thus, transactions in the ISO Control Area should generally be subject to the markets contemplated in the ISO Tariff unless a compelling policy reason dictates otherwise. However, Proponents have not set forth any compelling reason why the definition of Regulatory Must-Take Generation should be expanded to remove future must-take contracts from competition. They acknowledge that the contracts envisioned by the ISO for the special Regulatory Must-Take Generation treatment are limited to those facilities not subject to competition, such as nuclear and QF facilities.[35] Proponents' argument that Must-Take contracts should be protected because they are traditional to the industry is not convincing, especially in light of the new, non-traditional markets created and supported by the ISO structure. Market Participants are free to enter into such agreements, and must decide whether such arrangements remain economically beneficial under the rules of the new markets.

69. Finally, with regard to the definition of Eligible Regulatory Must-Take Generation, while qualification for that status may be a factor that a municipal entity may want to consider in deciding whether it chooses to open its system to direct access, Proponents have not demonstrated how any entity is "discriminatorily penalized" by the definition in the ISO Tariff. However, the Commission is concerned that municipals are unfairly excluded from qualifying as Eligible Regulatory Must-Take Generation based on the fact that the unit must be owned by an entity which "serves load in the ISO Control Area." As Proponents point out, certain of their units and contracts do not qualify because a joint action agency

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[34] E.g., Midwest Independent Transmission System Operator, Inc., 84 FERC ¶ 61,231 at 62,142 (1998) (promotion of fair and efficient competition is one of the basic goals by which to appraise an ISO proposal).

[35] Proponents' Reply Brief at 13.

such as M-S-R does not serve load directly but, rather serves load in the ISO Control Area through its members. The ISO has not provided any reason for such exclusion. In such circumstances, entities are unjustly denied Eligible Regulatory Must-Take Generation status. Accordingly, we direct that the ISO, within 30 days of the issuance of this order, revise the definition of Eligible Regulatory Must-Take Generation to include joint action agencies composed of entities that otherwise meet the definition.

9. Whether the five percent differential trigger for the establishment of new Congestion Zones is appropriate, and whether Commission approval should be obtained prior to any modification to a Congestion Zone or the establishment of a new Congestion Zone?

70. The ISO proposed a congestion management plan with four initial congestion Zones, two Active and two Inactive. The ISO Tariff provides that the creation of a new Zone will be considered if, over the course of a 12-month period, "the cost to alleviate the Congestion on a path is equivalent to at least 5% of the product of the rated capacity of the path and the weighted average Access Charge of the Participating TOs." ISO Tariff Section 7.2.7.2.1. The zone will be "Active" if the ISO Governing Board determines that "a workably competitive Generation market exists on both sides of the relevant Inter-Zonal Interface for a substantial portion of the year. . . ." ISO Tariff Sections 7.2.7.3.1 and 7.2.7.3.5.

71. In the October 1997 order, the Commission approved the 5 percent criterion, subject to further review.[36] The Commission explained that:

> We consider the 5 percent criterion a starting place. There is a trade-off between the administrative convenience of fewer Zones and the inefficiency of Congestion within a Zone. The proposed method for managing Intra-Zonal Congestion will spread the costs over all Scheduling Coordinators within a Zone regardless of whether a Scheduling Coordinator creates Intra-Zonal Congestion or not.[37]

72. The Commission noted that it may be appropriate to "refine" the 5 percent criterion as the ISO gains more experience about market operations, directed the ISO to conduct a study to evaluate the effectiveness of the 5 percent criterion and stated that it would reconsider the appropriateness of the criterion after evaluating the results of the ordered study.

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[36] October 1997 order, 81 FERC at 61,484.

[37] Id.

73. Cities/M-S-R and Palo Alto argue that the ISO's proposed criteria for establishing new congestion zones are not appropriate. Proponents contend that the study filed by the ISO in response to the October 1997 order is inadequate and does not contain data directed to be included by the Commission, nor does it establish the justness and reasonableness of the 5 percent trigger.[38] They claim that the ISO's congestion management plan results in improper cost shifts among transmission customer classes, i.e., customers within a Zone pay an excess portion of a Participating TO's revenue requirement while those outside the Zone pay less than their allocated share. Further, Proponents contend that the ISO Tariff does not include a definition of "workable competition," and advocate that the ISO apply the criteria for "workably competitive" set forth in the "Report on Redesign of Ancillary Service Markets" prepared by the ISO's Market Surveillance Committee.[39] They also argue that the Commission, and not the ISO, should determine whether new Congestion Zones should be created, since the creation of a new Zone is an exercise of ratemaking authority that cannot be delegated to the ISO. Proponents outline an alternative mechanism for the establishment of new Congestion Zones.

74. The ISO answers that the Commission's acceptance of Proponents' proposal could frustrate the stakeholder process initiated by the ISO in response to the Commission's directive to assess the comprehensive redesign of the its congestion management scheme.[40] Further, the ISO contends that it, and not the Commission, is the proper entity to determine whether the creation of new Congestion Zones is appropriate since the Commission is not in a position to launch an investigation every time the creation of a new Zone is proposed. It claims that the Commission, in addressing ISO Tariff Amendment No. 22, determined that the ISO is the proper entity to make such determinations and rejected Proponents' argument that the ISO had not defined "workably competitive."[41]

75. San Diego Gas & Electric Company (SDG&E) urges the Commission to reject Proponents' opposition to the creation of new Zones because it will frustrate the development of an efficient and competitive market. It contends that hourly prices must

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[38] See ISO filing of December 1, 1999, "Report to the Federal Energy Regulatory Commission: Studies Conducted Pursuant to the October 30, 1997 Order" (December 1999 Report), Docket No. ER00-703-000.

[39] Submitted by the ISO on October 19, 1999 in Docket No. ER98-2943-009.

[40] California Independent System Operator Corporation, 90 FERC ¶ 61,006 at 61,013-14, reh'g denied, 91 FERC ¶ 61,026 (2000).

[41] Citing California Independent System Operator Corporation, 89 FERC ¶ 61,229 at 61,681-82.

send correct signals to the market, and that more Zones are needed so that the pricing system can reflect the locational affects of congestion. Alternatively, SDG&E argues that the Commission should not address this issue in this proceeding as it is within the scope of the ISO/Stakeholder process on congestion management reform.

76. Proponents reply that the ISO is wrong to rely on the Commission's order regarding Amendment No. 22 because the Commission, on rehearing, clarified that its approval of a proposed new Zone was fact specific and was not intended "to imply that the current criteria are any more or less valid than when they were approved on an interim basis.'[42] Further, Proponents state that, while they intend to participate in the stakeholder process on congestion management reform, the Commission should not defer to another proceeding.

Commission Response

77. The October 1997 order recognized some of the same concerns expressed now by Proponents, such as costs shifting among customers. The Commission nonetheless accepted the 5 percent trigger on an interim basis or "a starting point," explaining "there is a trade-off between the administrative convenience of fewer Zones and the inefficiency of Congestion within a Zone.'[43] Proponents do not directly address the Commission's acceptance of the 5 percent trigger on an interim basis but, rather, direct their arguments toward an appropriate final scheme for the establishment of congestion zones. The issue in this proceeding, however, is limited to rehearing, and not the final scheme.[44] Proponents have not provided any rationale to reverse the Commission's acceptance of the 5 percent trigger on an interim basis. Accordingly, rehearing is denied on this issue.

10. Does the ISO Tariff contain an inappropriate inconsistency between the computation of the Wheeling Access Charge and the disbursement of Wheeling Revenues (sections 2.4.4.3.1 vs 7.1.4.3)?[45]

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[42]90 FERC ¶ 61,315 at 62,043-44.

[43]October 1997 order, 81 FERC ¶ 61,122 at 61,484.

[44]The issue of a final scheme for the establishment of new zones is more properly dealt with in Docket No. ER00-703-000, which is not included in the Outstanding Issue Proceeding. Moreover, the ISO's Comprehensive Market Design Proposal in Docket No. ER02-1656-000 includes a proposal to replace the current zonal approach with a nodal pricing system for congestion management.

[45]The reference to section 2.4.4.3.1 in the framed issue appears to be mistake, and

(continued...)

78. Proponent TANC argues that the Wheeling Access Charge is developed on a different basis from the disbursement of Wheeling Revenues and that, in the case of facilities owned by more than one Participating TO, this causes a mismatch of revenues collected and distributed. TANC claims that this inconsistency sends an improper signal to Participating TOs and is unduly discriminatory. Specifically, for Wheeling over joint facilities, the Scheduling Coordinator must pay the ISO each month a rate that reflects an average of the Wheeling Access Charge of the Participating TOs that own the joint facility, weighted by their ownership share in the facility. See ISO Tariff Section 7.1.4.2. In contrast, the ISO disburses Wheeling Revenues to Participating TOs based on the ratio of each Participating TO's Transmission Revenue Requirement (TRR) to the sum of all such Participating TO's TRRs. See ISO Tariff Section 7.1.4.3.1

79. According to TANC, this difference in methodologies for collection and disbursement of Wheeling revenues can cause a mismatch between the revenues generated by a Participating TO and the revenues it receives. It provides an example in which one of several Participating TOs that jointly own a facility has a majority ownership interest in the facility (and the highest access charge), and also has a significantly lower TRR than the other owners.[46] In this circumstance, the majority owner would receive less Wheeling revenues than the others for transmission over the jointly owned facility. TANC asks that the Commission grant rehearing[47] and direct that the ISO revise the Tariff so that the collection and disbursement of Wheeling revenues is made on the same basis.

80. The ISO answers that the ISO Tariff applies different, but appropriate, methods for determining Wheeling Access Charges and for disbursements of Wheeling revenues. It contends that it is reasonable to base Wheeling Access Charges on the proportionate shares of the capacity at a scheduling point owned by each Participating TO. Likewise, the ISO claims that it is reasonable to distribute Wheeling revenues in proportion to the Participating TO's TRR, since this enables each Participating TO to credit against the Access Charge paid by customers on the ISO-controlled Grid a portion of the Wheeling Access Charge revenues that is proportionate to the TRR upon which that Access Charge is based. The ISO acknowledges that this combination of approaches could result in a

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[45](...continued)
should refer to section 7.1.4.2 of the ISO Tariff in its stead.

[46]In its reply brief, TANC indicates that the example reflects its position as majority (79 percent) owner of the California-Oregon Transmission Project (COTP).

[47]The October 1997 order did not specifically address earlier pleading in which it raised this issue and therefore TANC's earlier request for relief on this issue is deemed denied by the order.

mismatch of charges, but contends that the objective is not to avoid such mismatches but, rather, to charge Wheeling Customers a reasonable rate for use of the ISO Controlled Grid and credit an appropriate amount to customers paying the Access Charge of each Participating TO. The ISO also notes that in Amendment No. 27, filed March 31, 2000 in Docket No. ER00-2019-000, it proposed to modify both the assessment of Wheeling Access Charges and the disbursement of Wheeling Revenues.

81. In its reply, TANC contends that, contrary to the ISO's position, the current disbursement of revenues is not reasonable and does not credit an appropriate amount to customers.

Commission Response

82. We will deny the Proponents request for rehearing on this issue. We find that the Proponents argument regarding the need for consistency between the computation of the Wheeling Access Charge and the disbursement of Wheeling Access Revenues is misplaced in the context of the operation of the CA ISO. Once an entity joins the CA ISO, its facilities are turned over to the CA ISO for unfettered use. Thus, these entities no longer have claim to the revenues that the use of these specific facilities may generate. While the CA ISO uses a weighted average revenue requirement approach for the calculation of wheeling access charges for use of jointly owned facilities, that use is solely to determine a reasonable charge for the entity desiring to wheel across the CA ISO grid and in does not require that the CA ISO disburse revenues for such wheeling based on the ownership shares associated with these facilities. Rather, the CA ISO's proposal to distribute Wheeling Access revenues to each Participating TO based on the ratio of the individual TO's Transmission Revenue Requirement (TRR) to the total TRR's of all Participating TO's is reasonable in the context of the CA ISO having unfettered use of all transmission facilities and entitlements that Participating TOs have turned over for its use. In this manner, all Participating TOs share the Wheeling Access Revenues generated by the use of the CA ISO grid without regard to the actual facilities used to generate such revenues consistent with the CA ISO having the right to use all of these transmission facilities in the most efficient manner. We also note that use of specific facilities by entities that desire to wheel across or through the CA ISO's grid will most likely change over time and the CA ISO's method of distributing Wheeling Access revenues based on the ratio of TRRs of the Participating TOs will be unaffected by such changes in usage patterns.

11. Whether section 2.4.4.5.1.6 of the ISO Tariff, which allows the ISO to make available any unused transmission capacity which has not been scheduled by the Existing Rights holder by the start of ISO's Hour-Ahead scheduling process, inappropriately allows for appropriation of transmission capacity without payment of compensation, is

inconsistent with preservation of within-the-hour scheduling flexibility, and could impair the interests of non-Participating Transmission Owners or Entitlements of Existing Contracts rights holders that were financed with tax-exempt bonds?

83. The October 1997 order provided that:

> [w]e disagree with DOE/OAK, TANC, Western and others who argue that the ISO should compensate those entities with existing capacity Entitlements for the use of that capacity in the hour-ahead market. [footnote omitted] Traditionally, if a customer did not utilize all of its transmission entitlement, the transmission provider and other third-party customers could utilize that capacity on a non-firm basis.[**48**]

84. TANC, Cities/M-S-R and Palo Alto argue that the above conclusion in the October 1997 order was based on the mistaken premise that the issue was limited to unused contract rights to transmission service. Proponents contend that, in addition, the ISO has taken an expansive view of its authority (under Section 2.4.4.5.1.6 of the ISO Tariff) to use, without compensation, transmission facilities owned by non-Participating TOs.

85. The ISO answers that Proponents are mistaken. Section 2.4.4.5.1.6 of the ISO Tariff applies only to contractual reservations of capacity on transmission facilities and Entitlements of Participating TOs. Thus, the provision only authorizes the ISO to make available to other Market Participants unused transmission capacity associated with Existing Rights, i.e., idle transmission capacity on the ISO Controlled Grid that had been reserved under an Existing Contract. Section 2.4.4.5.1.6 does not permit the ISO to make available to other Market Participants capacity on transmission facilities or Entitlements that have not been turned over to its Operational Control. Rather, ISO "control" over such facilities is limited to the implementation of operating instructions contained in Existing Contracts between investor-owned utilities that were operating control areas in California prior to the start-up of the ISO and non-Participating TOs. According to the ISO, former control area operators have provided operating instructions to the ISO with respect to these contracts, under which the ISO has carried out scheduling and other responsibilities.

86. The Proponents reply that they "accept the ISO's explanation" of its authority under Section 2.4.4.5.1.6 of the ISO Tariff, and ask the Commission to accept this explanation as the proper interpretation of the provision.

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[48] October 1997 order, 81 FERC ¶ 61,122 at 61,471.

Commission Response

87. Based on the representation of the parties noted above, we consider this matter resolved and will not be addressed here.

12. With respect to ISO Tariff Amendment No. 7, can the ISO's "temporary rule" to impose a price cap for imbalance energy bids evaluated by the ISO's BEEP software be used to bar generators from bidding above the price cap to supply Imbalance Energy?

88. No party filed a brief on this issue. Accordingly, this issue is dismissed.

13. Whether the priority for Reliability Must-Run Generation in Amendment No. 7 is improper?

89. In Amendment No. 7 to the ISO Operating Agreement and Tariff, the ISO proposed, inter alia, changes to the ISO's Schedules and Bids Protocol (SBP) and Scheduling Protocol (SP) that would give highest curtailment priority to Reliability Must-Run (RMR) Generation, and second-highest priority to Existing Contract uses. In California Independent System Operator Corporation,[49] the Commission stated that "while our analysis indicates that the framework proposed by the ISO complies with our earlier orders, various Intervenors have identified the need for more clarification as to the specific prioritization of Existing Contracts. Accordingly, we again direct the ISO to work with the affected parties with Existing Contracts to continue to resolve the details of this issue within the framework proposed by the ISO'[50]

90. In their initial brief, Turlock, Cities/ M-S-R, DWR, EPUC and CAC point out that, while the above language directs the ISO and stakeholders to continue to work together to resolve the curtailment priority issue, ordering paragraph C of the same order accepted Amendment No. 7 with one specific exception that is not relevant here.[51] Thus, they contend that, without directly addressing the proposal's impact on Existing Contract rights, the Commission accepted the ISO's proposed priority for RMR Generation. On rehearing, Proponents argue that RMR Generation should not have a curtailment priority above that applied to firm transmission service under Existing Contracts and requirements to take delivery of Must-Take generation of QFs under Existing Contracts.

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[49] 83 FERC ¶ 61,209 at 61,922.

[50] Id.

[51] Id. at 61,924.

91. Proponents provide a detailed dissertation of their transmission rights under Existing Contracts to make the point that none of these contracts provide for a curtailment priority lower than RMR Generation. They then contend that the ISO's proposal will result in a partial abrogation of rights under Existing Contracts by subjecting firm transmission service and must-take generation to additional curtailments which, absent the California restructuring, would not have occurred. They argue that this result is contrary to the Commission's consistent policy of honoring Existing Contract rights,[52] and contrary to the Commission's earlier rejection of a similar ISO proposal relating to the priority of Pacific Gas & Electric Company's (PG&E's) Regulatory Must-Take and Regulatory Must-Run generation on Path 15, on the grounds that the proposal violated Existing Contract rights.[53]

92. Proponents also claim that the "super-preference" for RMR Generation is not necessary to maintain system reliability because: (1) prior to establishment of the ISO, the four control areas maintained reliability while honoring existing contracts and without an RMR Generation preference; (2) RMR Generation is local in nature and giving it priority over Inter-zonal constraints "is merely substitut[ing] one like energy source for another, without achieving any enhancement in reliability or efficiency;"[54] (3) it may contribute to Overgeneration; and (4) the priority use of RMR Generation will penalize utilities and other contract-holders such as QFs that may be curtailed to preserve the preference for RMR units.

93. The ISO answers that Proponents fail to recognize that the fundamental purpose of the dispatch of RMR Generation is to maintain the reliability of the ISO-Controlled Grid. Thus, it insists that RMR Generation must have top priority to ensure the delivery of energy

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[52]Citing October 1997 order at 61,463-74; and Order Nos. 888 and 888-A. Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. and Regs., Regulations Preambles January 1991-June 1996 ¶ 31,036 (1996), order on reh'g, Order No. 888-A, FERC Stats. and Regs., Regulations Preambles July 1996-December 2000 ¶ 31,048 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998), aff'd in part and reversed in part sub nom. Transmission Access Policy Study Group, et al. v. FERC, 225 F.3d 667 (D.C. Cir. 2000), aff'd, New York v. FERC, 122 S.Ct. 1012 (2002).

[53]California Independent System Operator Corporation, 82 FERC ¶ 61,312 at 62,242-43 (1998) (rejecting ISO proposed Amendment No. 3).

[54]Proponents Initial Brief at 19-20.

under Existing Contracts. The ISO also disagrees that its proposal will result in the partial abrogation of Existing Contracts, as alleged by Proponents. It contends that the local nature of RMR Generation will not adversely affect service elsewhere under Existing Contracts. Moreover, the ISO explains that, while Existing Contracts could not possibly reflect the market restructuring that would occur years later, the same contracts referred to by Proponents typically do permit curtailment consistent with Good Utility Practice or for emergency purposes, i.e., overall management of the system for reliability.

94. The ISO further argues that the current issue is different than the Amendment No. 3 proposal, rejected by the Commission. While the priority of Regulatory Must-Take and Regulatory Must-Run resources, at issue in the latter proceeding, were created out of a need to preserve certain existing contractual, legal and regulatory obligations, the curtailment priority of RMR Generation resources at issue here is necessary to preserve system reliability. Finally, the ISO makes clear that it did not intend to establish a priority for generation sold from an RMR unit when that unit is selling generation in the market, but only when that unit is called upon by the ISO for reliability reasons.[55]

95. In reply, Proponents concur with the ISO that RMR Generation may be dispatched to avoid an imminent System Emergency or to rectify an Existing System Emergency. Proponents state that, while they have little concern with the ISO using RMR Generation to meet NERC and WSCC reliability criteria, the dispatch of RMR units to meet "local reliability criteria" may result in dispatch in response to circumstances that are not true System Emergencies. They object to RMR units receiving curtailment priority when dispatched to remedy market inefficiencies such as congestion, price increases in energy, exercise of market power or economic emergencies. They contend that these concerns are heightened when RMR units receive priority in the case of Inter-Zonal Congestion, and that the ISO's position cannot be reconciled with the fundamentally local nature of RMR Generation.

Commission Response

96. The Commission denies Proponents' request for rehearing on this issue. The ISO states in its Answer that the fundamental purpose of the dispatch of RMR Generation is to maintain the reliability of the ISO Controlled Grid, which in turn, permits the deliveries of energy under the Existing Contracts. We agree that the curtailment of transmission of RMR Generation should have the highest priority in those situations where its dispatch is necessary for the continued reliability of the ISO Controlled Grid. We note that

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[55] In its Answer, CPUC refers to arguments elsewhere in its brief relating to issues of Overgeneration. CPUC does not explain how the cross-referenced arguments relate to the current issue.

Scheduling Protocol 7.2.2 of the ISO's tariff, Prioritization of Transmission Uses, states that "regardless of the success of the application of such [protocols] rules, it is intended that the rights under Existing Contracts will be honored by the ISO Tariff." Section 2.4.3.1 of the ISO Tariff states that the Participating TO, the holder of transmission rights and the ISO will work to develop operational protocols which allow existing contractual rights to be exercised in a way that "(i) maintains the existing schedules and curtailment priorities under the Existing Contract. . . ." Thus, we reaffirm that our approval of the ISO's curtailment prioritization for transmission of RMR Generation is limited to reliability and believe that this curtailment prioritization is reasonable and consistent with the ISO's commitment to honor Existing Contracts' curtailment provisions.

14. Did the commission's October 30, 1997 decision to strike certain overgeneration provisions of the ISO Tariff result in consequences of overgeneration to be borne only by some, and not all of the responsible parties, and did it produce an inequitable and discriminatory result.

97. The October 1997 order found that the ISO's proposed three-step process to resolve Overgeneration conditions was unjust and unreasonable.[56] The rejected provisions would have, in certain circumstances, allocated responsibility for Generation reductions necessary to manage Overgeneration conditions among the PX and other Scheduling Coordinators serving Direct Access End-Users in the Service Areas of the Participating TOs.[57] The Commission directed the ISO to modify the Overgeneration procedures, explaining that:

> We do not believe that Overgeneration should be a permissible exception to the balanced schedule requirement. We see no reason why one Scheduling Coordinator should be forced to serve its demand with the Must-Take Generation included in another Scheduling Coordinator's schedule. We direct the ISO to modify the ISO Tariff to require all Scheduling Coordinators to individually resolve problems of excess generation due to their obligations with respect to Regulatory Must-Run and Regulatory

[56] October 1997 order, 81 FERC ¶ 61,122 at 61,525-26. Appendix A of the ISO Tariff defines Overgeneration as "a condition that occurs when total Generation exceeds total Demand in the ISO Control Area."

[57] See id. at 61,523-24 for a detailed description of the ISO's proposal.

> Must-Take Generation . . . and submit balanced schedules to the ISO in the Day-Ahead market. [58]

98. Proponents PG&E and SoCal Edison argue that the Commission's decision rejects a key compromise among End Users and their representatives. They also contend that the Commission's ruling, not the ISO proposal, creates cost-shifting by not burdening all End-Use customers equally. They argue that, since they made commitments to Regulatory Must-Take Generation and Regulatory Must-Run Generation to meet the needs of all End-Use Customers that the Participating TOs served prior to the implementation of direct retail access, Scheduling Coordinators now serving those same customers should contribute to the solution of Overgeneration conditions created by that generation. According to Proponents, the ISO's proposal was designed to ensure that the responsibility for Overgeneration would be borne by the same set of End-Use customers before and after restructuring. They argue that the Commission's rejection of the provision allows former End-Use customers to escape responsibility for contractual and regulatory commitments made on their behalf by the Participating TOs.

99. Joint Respondents, consisting of Turlock, NCPA, TANC, Modesto, Santa Clara, City of Redding, M-S-R Public Power Agency and SMUD, answer that the rejected procedures are unjust, unreasonable and unduly discriminatory since they would have required Scheduling Coordinators that matched their generation levels to meet load to curtail their generation schedules, spill water, or dispatch out of economic merit order to assist a Participating TO in remedying its failure to match its resources with its load. They contend that, contrary to Proponents' claims, municipal entities did not share the economic consequences of Overgeneration prior to restructuring since each such entity undertook its own planning for resources to meet its load, and paid a penalty under their interconnection agreement with the utility if scheduled resources failed to match their load. Thus, according to Joint Respondents, the rejected Overgeneration procedures did not honor historical contractual and regulatory commitments. Southern Cities respond that, while Proponents claim that the rejected Overgeneration procedures would have affected only Scheduling Coordinators that schedule on behalf of current and former End-Use customers of the current Participating TOs, the language of the rejected provision does not confine responsibility in those terms.

100. The ISO answers that reinstatement of the Overgeneration procedures is not necessary because, pursuant to revisions to the ISO Tariff stated in Amendment No. 13, it now resolves real-time Overgeneration through economic bids. It contends that special

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[58] Id. at 61,526.

rules are not needed to resolve a problem that the market is able to solve efficiently through bids submitted by Scheduling Coordinators.

101. CAC/EPUC and CPUC each filed Answers supporting Proponents, concurring that the rejected procedure sought to spread responsibility for Overgeneration to the former bundled retail customers of Participating TOs. SDG&E and TURN/UCAN also express support for Proponents' position.

102. SoCal Edison replies that neither Joint Respondents nor Southern Cities address the actual substance of their position – that former, retail customers of a Participating TO should be treated identically. They contend that Joint Respondents and Southern Cities misconstrue Proponents' position which would call for the sharing of the burden to resolve Overgeneration problems with the End-Use customers of the Participating TOs, not the End-Use customers of municipal utilities or the municipal entities themselves.

Commission Response

103. We note at the outset that The PX's wholesale rates schedules were terminated as of April 30, 2001, thereby eliminating the Day-Ahead and Hour-Ahead markets operated by the PX.[59] Thus, the remedy requested by the Proponents, to reinstate the ISO proposal that was rejected in the October 1997 order, is no longer viable.

104. Moreover, we deny rehearing on the Proponents' underlying contention that it was unjust and unreasonable for the Commission to direct that the ISO modify the ISO Tariff to require all Scheduling Coordinators to individually resolve Overgeneration problems due to their obligations with respect to Regulatory Must-Run and Regulatory Must-Take Generation. Proponents raise no new arguments that would persuade us to make an exception to the ISO Tariff provisions making Scheduling Coordinators responsible for their own overgeneration and requiring Scheduling Coordinators to submit balanced schedules.[60]

15. Whether the Commission erred in requiring modification of the liability provisions in sections 14.1 and 14.2 of the ISO Tariff?

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[59] See San Diego Gas & Electric Co., 93 FERC ¶ 61,294 at 61,999 (2000).

[60] We note that the ISO, in Docket No. ER02-1656-000, has proposed to eliminate the balanced schedule requirement and allow trading of net imbalances. This proposal, when implemented, should help address the overgeneration situations that Scheduling Coordinators may face.

105. The October 1997 order directed the ISO to revise section 14.1 (liability for damages) and section 14.2 (exclusion of certain types of loss) of the ISO Tariff as overly broad.[61] Section 14.1, as proposed, provided that the ISO would not be liable for damages "except to the extent that its breach of the provisions of the ISO Tariff results directly in physical damage to property owned, operated by or under the Operational Control of any Market Participant or in the death or injury of any person." Section 14.2, as proposed, provided that the ISO should not be liable for consequential damages or indirect financial loss. The Commission rejected the ISO's reasoning that it was entitled to a broad exculpatory clause limiting liability because of its not-for-profit status, and stated that:

> We believe that the determination of the ISO's or PX's liability in instances of negligence or intentional wrongdoing is best left to appropriate court proceedings, in which the parties will be free to advance any appropriate argument. We direct that sections 14.1 and 14.2 of the ISO Tariff . . . be modified so as not to provide any limitation on liability of the ISO or PX in cases of their negligence or intentional wrongdoing.[62]

106. The ISO argues on rehearing that the Commission erred in directing the changes to sections 14.1 and 14.2. It argues that the limitation on liability is consistent with California law, which limits liability for public utilities.[63] It also contends that California utilities are protected from exposure to consequential damages, and that the Commission itself has routinely accepted provisions limiting liability for consequential damages.[64] It claims that, at a minimum, the Commission should act consistent with its precedent and allow the ISO to adopt a gross negligence standard for activities performed by the ISO that go beyond the administration of a pro forma open access transmission tariff (OATT).[65]

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[61] October 1997 order, 81 FERC ¶ 61,122 at 61,520.

[62] Id.

[63] Citing Waters v. Pacific Telephone Company, 523 P.2d 1161 (1974).

[64] Citing, e.g., National Fuel Gas Supply Corporation, 80 FERC ¶ 61,040 at 61,121 (1997); Shell Gas Pipeline Company, 76 FERC ¶ 61,126 at 61,692 (1996).

[65] Citing New York Independent System Operator, Inc., 89 FERC ¶ 61,196 at 61,604 (1999) (accepting gross negligence standard for NewYork ISO's market monitoring activities); Central Hudson Gas & Electric Corporation, 88 FERC ¶ 61,138 at 61,384 (1999).

107. TURN/UCAN answers that it supports Proponents' position, but offers no substantive arguments. CPUC indicates that it has no position on the issue.

108. Answering briefs opposing the ISO's position were filed by PG&E; Dynegy; jointly by Western Power Trading Forum and Enron Power Marketing, Inc. (WPTF/ Enron); and jointly by TANC, Cities/M-S-R, Palo Alto, Modesto, and MWD. Those opposing the ISO generally raise similar arguments. They contend that the Commission adopted a traditional negligence standard in section 10.1 of the pro forma OATT and in Order No. 888 and that the ISO should be held to that standard.[66] They also argue that the ISO would be held to a simple negligence standard under California state law, and that in any case the services administered by the ISO are subject to Commission policy and not state law. They argue that, while the Commission accepted NYISO's gross negligence standard for action under its non-transmission related tariffs, the California ISO seeks to apply the standard to services contained within its OATT. They also contend that the Commission accepted a gross negligence standard for certain NYISO functions as consistent with New York law and therefore cannot be applied to the California ISO. All contend that the ISO must remain accountable for its actions.

109. The ISO replies that, while the indemnity provision of the pro forma OATT specifies a negligence standard, it is silent on the issue of liability, instead relying on state law. It then brings additional precedent to support its position that California law supports a more protective standard of liability for the ISO. The ISO states that, in Order No. 2000, the Commission decided to determine the extent of the Regional Transmission Organization (RTO) liability on a case-by-case basis,[67] and thus removed any possible presumption that an ordinary negligence standard should apply to the ISO. Further, it contends that the Commission's NYISO decisions are relevant because the ISO performs many similar functions, the fact that the NYISO memorialized certain functions in a separate tariff is not a distinguishing factor, and California law is similar to New York law on the issue of utility liability.

Commission Response

110. As mentioned above, the October 1997 order directed the ISO to remove the liability provisions from the Tariff. The ISO appears to have misunderstood this directive

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[66]Citing Order No. 888, FERC Stats. and Regs., Regulations Preambles January 1991-June 1996 ¶ 31,036 at 31,765-66.

[67]Regional Transmission Organizations, Order No. 2000, FERC Stats. and Regs., Regs. Preambles ¶ 31,089 at 31,106 (1999), order on reh'g, Order No. 2000-A, FERC Stats. and Regs., Regs. Preambles ¶ 31,092 at 31,373-74 (2000).

as it arguments relate to the proper standard of liability and not whether liability provisions are appropriate for an open access transmission tariff in the first instance. Further, we note that, in response to the October 1997 order, the ISO did not delete sections 14.1 and 14.2 of the Tariff as directed but, rather, modified them to specify a negligence standard for liability and the recovery of consequential damages.[68]

111. The Commission recognizes that, in the wake of Order No. 888, restructuring changes have occurred within the electric industry and that limited liability provisions may be appropriate for inclusion in Commission tariffs under certain circumstances such as where there is no liability protection under state law.[69] We note that, in the instant proceeding, the ISO and parties filing reply comments disagree regarding the liability standard to which the ISO would be held under California law.

112. The Commission is considering the matter of liability provisions in its generic rulemaking proceeding regarding open access transmission service and standard market design (SMD proceeding).[70] In this regard, any comments received in the SMD proceeding will aid the Commission in determining how best to resolve this issue for transmission providers such as the ISO. We also note that the Commission intends to convene a technical conference regarding limited liability provisions subsequent to the issuance of its notice of proposed rulemaking in the SMD proceeding. Interested parties and Staff will be able to explore in an industry-wide context issues regarding limited liability provisions in OATTs. Following the conference, parties will have an opportunity to file written comments, which will help form the basis for further Commission action on this issue.

113. We will reverse our earlier decision and, consistent with MISO, allow the ISO to include liability provisions in the ISO Tariff.[71] In MISO, the Commission conditionally accepted a provision that would limit MISO and transmission owner liability to direct damages (precluding, for example, incidental and consequential damages) for ordinary

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[68]See ISO's June 1, 1998 compliance filing. Issues raised in response to this filing were included in the outstanding issues proceeding and, thus, the Commission has not acted on the ISO's proposed revisions to sections 14.1 and 14.2.

[69]See Midwest Independent Transmission System Operator, Inc., 100 FERC ¶ 61,144 at P 24-26 (2002) (MISO).

[70]See Notice of Proposed Rulemaking on Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design, 100 FERC ¶ 61,138 at P 385-89 (2002) (Standard Market Design Rulemaking).

[71]MISO, 100 FERC ¶ 61,144 at 61,545.

negligence, gross negligence and intentional misconduct. The Commission, however, directed MISO to remove a proposed cap on ordinary negligence and made the acceptance subject to the final outcome of the Commission's Standard Market Design Rulemaking.[72] Here, we deny the California ISO's request to reinstate its original proposal that would excuse the ISO from liability except in cases where its breach of the provisions of the ISO Tariff results directly in damage to the person or property of market participants. Rather, we accept the ISO's revised tariff language, submitted in its June 1, 1998 compliance filing, that allows for the recovery of both direct and consequential damages that result from negligence or intentional wrongdoing on the part of the ISO.[73] Our acceptance, as in MISO, is subject to the final outcome of the Commission's Standard Market Design Rulemaking.

16. Whether the MSS concept under the ISO Tariff should be limited so that it would only be used as a vehicle to respect existing operational capabilities for Existing Rightsholders?

114. In the October 1997 order, the Commission stated that "[m]any parties state that allowing a Scheduling Coordinator to qualify as a Metered Subsystem operator is critical. We agree that this is a critical feature and urge the ISO Governing Board to consider this issue with a high priority."[74] The ISO asks that the Commission clarify that MSS status should be limited to entities (in particular, existing Governmental Entities) that had been operating as utilities, prior to the formation of the ISO under Existing Contracts. The ISO believes that the Commission's reference to Scheduling Coordinators qualifying as MSSs was not intended to expand the scope of the concept. Rather, the Commission simply recognized that all market interaction by the ISO is with Scheduling Coordinators, e.g., the load and resources of an existing Governmental Entity that qualifies as an MSS must be represented by a Scheduling Coordinator.

115. The ISO states that the MSS concept was introduced to facilitate participation by existing governmental entities that had been operating as vertically integrated electric utilities, and that it was envisioned as a potential transitional mechanism to enable such entities to continue to utilize their Existing Rights and to participate in the ISO's markets, without terminating or requiring revisions to their Existing Contracts. According to the ISO, it was never intended that new MSSs should be created by allowing Scheduling Coordinators to acquire physical assets or associated contract rights.

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[72] Id.

[73] The Commission's acceptance of this provision is without prejudice to the ISO making a new filing that limits its liability to direct damages, as permitted in MISO.

[74] Id. at 61,496.

116. WPTF/Enron answer that the Commission should reject the ISO's attempt to limit the use of the MSS concept to Existing Rights holders because it would discriminate against non-incumbent market participants, who need the same flexibility to participate in the ISO markets as do Existing Rights holders. They also challenge the ISO's claim that the MSS concept was intended only as a "transition mechanism" as a post hoc rationalization.

117. SDG&E recommends that the MSS concept be abandoned but, if the concept is to remain, it concurs with the ISO that the MSS should be limited to use as a transitional vehicle to respect operating capabilities for Existing Rights holders. Joint Respondents (Cities/M-S-R, Modesto and Palo Alto) generally concur with the ISO's position but raise an admittedly tangential question whether it is appropriate to characterize MSS as a "transitional mechanism" that terminates with Existing Contracts. They also prefer that the Commission not rule on the issue in the current proceeding but, rather, leave it to further development in a stakeholders' forum. TURN/UCAN supports Proponents' position, but offers no substantive arguments. CPUC "tentatively" supports the ISO's position, but prefers that all MSS issues be dealt with together in a separate docket. PG&E also prefers that the Commission not decide MSS-related issues in this proceeding. SoCal Edison contends that the issue is moot by the terms of the ISO Tariff because no Existing Operating Entities became an MSS prior to ISO start-up.

118. In reply, the ISO concurs that questions related to the MSS concept should be resolved in a separate proceeding.

Commission Response

119. On July 15, 2002, the ISO filed proposed Amendment No. 46 to the ISO Tariff, which represented a comprehensive settlement of MSS-related issues. The proposal included a revised definition of MSS, which specifies that the MSS concept applies only to municipal utilities, water districts, irrigation districts, State agencies or Federal power administrations.

120. On August 30, 2002, the Commission issued an order that, inter alia, accepted the ISO's revised MSS definition, with one exception that is not relevant here.[75] Accordingly, the clarification requested by the ISO is no longer necessary, and the issued is dismissed as moot.

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[75]California Independent System Operator Corporation, 100 FERC ¶ 61,234 at 61,835 (2002), pending rehearing.

17. Whether End-Use meters of ISO metered entities should all be grandfathered or whether there should be a case-by-case evaluation?

121. In its August 1997 filing, the ISO expressly provided that the End-Use meters of Scheduling Coordinator Metered Entities (SCMEs) in place as of the ISO Operations Date would be grandfathered, i.e., deemed to be certified in conformance with ISO standards. However, the ISO proposal did not expressly grandfather the End-Use meters of ISO Metered Entities (ISOMEs), defined as any entity directly connected to the ISO Controlled Grid, including an End-User (except for an End-Users who purchases all of its energy from the UDC in whose Service Area it is located). To resolve this discrepancy, the October 1997 order directed the ISO to modify the ISO Tariff to grandfather all End-Use meters in place as of the ISO Operations Date.[76] The ISO subsequently revised section 10.2.4 to comply with the Commission's directive.

122. The ISO seeks clarification that, while the October 1997 order required that End-Use Meters of ISOMEs would be deemed certified, it did not override the ISO's authority under section 10.2.2 of the ISO Tariff to require meter upgrades of ISOMEs when necessary to maintain system reliability or enhance operation of the CAISO markets.[77] It explains that such upgrades may be necessary for some categories of grandfathered End-Use Meters of ISOMEs because: (1) depending on size and location they may impact dispatch by the ISO; (2) meter error may be contributing to high Unaccounted for Energy calculations; (3) certain grid-connected loads may not be meeting the power factor requirements specified in section 2.5.3.4 of the ISO Tariff; and (4) revisions to Intra-Zonal Congestion management may have an effect on the ISO's metering, data collection and communication requirements. The ISO adds that it would invoke a stakeholder process to determine whether to propose that certain categories of End-Use meters of ISOMEs need upgrading.

123. Southern Cities answers that it does not oppose the ISO's request for clarification provided that the ISO add specific language indicating that, when directing meter upgrades,

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[76] October 1997 order, 81 FERC ¶ 61,122 at 61,516.

[77] Section 10.2.2 provides:

> [t]he ISO may require ISO Metered Entities to install, at their cost, additional meters and relevant metering system components, including real time metering, at ISO specified Meter Points or other locations as deemed necessary by the ISO, in addition to those connected to or existing on the ISO Controlled Grid at the ISO Operations Date, including requiring the metering of transmission interfaces connecting Zones.

the ISO will consider "whether the expected benefits of such equipment are sufficient to justify such increased costs." Southern Cities state that the ISO previously agreed to add this language to ISO Tariff section 10.2.2 and Metering Protocol 5.1.1.

124. CAC/EPUC oppose the request for clarification, claiming that the ISO seeks to undo the grandfathering provision specifically required by the October 1997 order. They argue that, by its terms, section 10.2.2 only applies to "additional meters" and not to upgrades of existing grandfathered meters. They also argue that the ISO did not provide any support for its claim that existing meters contribute to problems with Unaccounted for Energy and Intra-Zonal congestion. CAC/EPUC state that the ISO did not provide any detail regarding the new metering requirements it seeks, the process it plans to use to impose new metering requirements on grandfathered meters, and whether it intends to seek further Commission approval before requiring meter upgrades.

125. In reply, the ISO acknowledges its previous consent to the language addition requested by Southern Cities. The ISO states that it is not seeking to "eradicate" the rights of grandfathered meters, as claimed by CAC/EPUC. With regard to the argument that section 10.2.2 only permits the ISO to order the installation of additional meters as opposed to upgrades of existing meters, the ISO answers that this is a "distinction without a difference" since the new ISO certified meter can either (1) be replaced, i.e., upgrade an existing meter or (2) be installed in addition to the existing meter.

Commission Response

126. CAC/EPUC have not shown that sections 10.2.2 and 10.2.4 are necessarily contradictory. (Nor have they demonstrated an intent by the ISO to misapply its authority under section 10.2.2 to renege the grandfathering of End-Use Meters owned by ISOMEs.) The initial certification of a meter does not mean that it complies for all time with the ISO's meter standards set forth in Appendix J of the ISO Tariff. It is not difficult to perceive of situations where, for example, technological advances, changes in ISO operations or degradation of individual meters could justify upgrades of previously-certified meters. Further, we agree with the ISO that the difference between an upgrade and an addition is not apparent for purposes of section 10.2.4. Thus, we grant clarification that section 10.2.2 was not overridden by the directive to grandfather all End-Use meters.

127. We find that the revision requested by Southern Cities, and agreed to by the ISO, is reasonable as it requires the ISO to consider the costs and benefits before deciding whether to direct meter upgrades. The ISO should submit revised Tariff sheets to reflect this change within 30 days from the date of this order.

The Commission orders:

(A) Rehearing is hereby granted in part, and denied in part, as discussed in the body of this order.

(B) The California Independent System Operator Corporation is hereby directed to submit a compliance filing, within thirty days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Linwood A. Watson, Jr.,
Deputy Secretary.