UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

	)	**Docket Nos. ER00-2360-000**
Pacific Gas & Electric Company	)	**ER00-2360-001**
	)	
	)	

INITIAL BRIEF OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

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To: The Honorable Bruce L. Birchman,
Presiding Administrative Law Judge

Pursuant to Rule 706 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.706 (2000), and the Order Concerning Trial Schedule issued by the Presiding Administrative Law Judge in the above-captioned proceeding on March 13, 2001, the California Independent System Operator Corporation ("California ISO" or "ISO") submits its Initial Brief in this proceeding.

I. STATEMENT OF THE CASE

As part of the restructuring of the California electricity system, Pacific Gas and Electric Company ("PG&E") turned control of its transmission facilities over to the California Independent System Operator Corporation ("ISO"). *See generally Pacific Gas & Electric Co.*, 81 FERC ¶ 61,122 (1997). The ISO provides transmission service over those facilities under the terms of the ISO Tariff, on file with the Commission. *Id.* In providing service under the ISO Tariff, the ISO must honor Existing Transmission

Contracts ("ETCs"). Exh. ISO-1 (Le Vine Direct Answering Testimony) at 16:9-13. The rates for service on PG&E's transmission facilities, other than service pursuant to ETC's, are determined according to PG&E's Transmission Owner Tariff ("TO Tariff"). Exh. PG&E 20 (Kozlowski Rebuttal Testimony) at 24:2-4. Under the ISO Tariff, the ISO charges PG&E, as the Participating Transmission Owner ("PTO"), for certain services provided by Reliability Must-Run ("RMR") Units and for certain out-of-market dispatch calls. Exh. ISO-1 at 7:16, 9:16-20, 10:1-4.

On April 28, 2000, PG&E tendered for filing with the Commission a new Reliability Services ("RS") Tariff intended to establish retail and wholesale rates for the recovery of reliability charges that the ISO imposes on PG&E. Noting that the costs of these reliability services had historically been allocated solely to PG&E's retail transmission customers, PG&E proposed to modify this allocation in order to recover these costs from all of its TO Tariff customers, which includes retail and new wholesale users, and its ETC customers. Exh. PGE-1(Kolzowski Prepared Direct Testimony) at 8:13-17; Exh. PGE-19 (Kolzowski Rebuttal Testimony) at 1:18-22, 2:1-19. The ISO moved to intervene in this proceeding on May 19, 2000.[1]

On July 12, 2000, the Commission accepted PG&E's RS Tariff for filing, subject to refund, and set the matter for hearing. *Pacific Gas & Electric Co.,* 92 FERC ¶ 61,021 (2001). A hearing concerning the issues and facts in this proceeding was conducted before Judge Birchman from February 22 to March 13, 2001.

[1] On May 16, 2000, PG&E filed errata to its April 28, 2000 filing. The Commission assigned that filing Docket No. ER00-2360-001. The ISO moved to intervene in that subdocket on June 6, 2000.

II. DISCUSSION OF ISSUES

In accordance with the agreement of the parties, the California ISO presents its discussion of the issues raised in this proceeding under the headings set forth in the Joint Stipulation of Issues as adopted by the Presiding Judge on March 23, 2001. Consistent with its position in the Joint Stipulation of Issues, the ISO limits its discussion to Issues 5.A, 5.B, 5.C, 5.J, and 5.M., and 7.1.

Issue 5.A: What is the Purpose of Reliability Must-Run ("RMR") Contracts and Local Out of Market ("OOM") Calls?

The purpose of Reliability Must-Run ("RMR") Contracts was quite succinctly and accurately described by Judge Peter H. Young in his Initial Decision in *Pacific Gas and Electric Co.*, 91 FERC ¶ 63,008 at 65,103 (2000):

> The integrated electric systems in California and elsewhere, historically, were designed to minimize system cost (and thus the price to customers). In some cases, this meant using generating units to perform tasks which are essentially transmission system functions. Because of this design feature, some generating units "must-run" at certain times in order to ensure system reliability. This remains true even in deregulated markets. When transmission constraints limit imports into certain areas (known as "load pockets"), generation located near load is needed to serve local customers. In other cases, generation must be operated to protect the system from voltage collapse, instability, and thermal overloading. If local generation were not operating in such instances, for example because it was not already scheduled to run for the market, the ISO would risk equipment damage or would need to shed customer loads.
>
> . . . The RMR Agreements also enable the ISO to dispatch the units to provide ancillary services . . . when needed on a regional or even statewide basis.
>
> When a unit is dispatched by the ISO in such circumstances, it is needed to deliver energy or provide voltage support regardless of price. Consequently, those unit owners at that time have local market power (*i.e.*, could potentially charge a high price in the absence of the RMR Agreement). Such local market power extends only to those times when

> the units are required to serve a reliability function. In response to such circumstances, the RMR Agreements were created to prevent the generation owners from taking advantage of local-specific market power.

Judge Young's description is fully supported by the record. Exh. PGE-20 (Kozlowski Rebuttal Testimony) at 3:7-24; Exh. ISO-1 (Le Vine Direct Answering Testimony) at 5:15-19; Exh. PGE-24R (Weingart Revised Rebuttal Testimony) at 7:22-28.

Two aspects of the purpose of RMR Contracts are particularly relevant to the issues in this proceeding. First, RMR Contracts serve a transmission purpose. Exh. PGE-1 (Kolzowski Direct Testimony) at 9:27-29,10:1-10, Tr. at 315: 6-25 (Weingart); Tr. at 1302:16-19 (Le Vine). The Dispatch notice to a RMR Unit enhances local reliability on the ISO Controlled Grid, and having a unit generate at minimum levels provides voltage support to the local area. Tr. at 1403:13-17; *see also* California Independent System Operator Corporation FERC Electric Tariff First Replacement Volume No. 1, definition of Reliability Must-Run Generation. Although RMR Units generate Energy in response to RMR Dispatch notices, that Energy is sold in the markets, presumably to serve the purchasers' Load. Tr. at 291:18-12 (Weingart). The RMR Owner must credit the Energy payments received from the markets against the charges to PG&E (unless the owner chooses to accept the market payment in lieu of the RMR Contract variable cost payment). Exh. PGE-16 (Weingart Direct Testimony) at 7:10-12, Tr. at 289:13-25(Weingart), Tr. at 291:8-19 (Weingart), Tr. at 1374:10-16 (Le Vine). Thus, PG&E is only charged, and is only including in its RS costs, the *incremental* costs attributable to the dispatch of the RMR Unit under the RMR Contract for transmission reliability purposes.

Second, the need to protect against locational market power through the RMR Contracts only exists when a transmission constraint requires the ISO to dispatch the RMR Unit for transmission reliability purposes. *See generally* Exh. PGE-24R at 7:22-28, 288:16-21. RMR Contracts do not, therefore, serve as an overall protection against the exercise of market power. During times when there are no transmission constraints or local reliability issues, the RMR Contracts will not constrain a Generator that has control of sufficient Generation to influence the Market Clearing Price.

Finally, one aspect of the purpose of RMR Contracts is irrelevant to this proceeding. Although the ISO may call upon RMR Units under the RMR Contracts to provide Ancillary Services, it may only do so when it has exhausted all Ancillary Services bids in the market. Trial Stip. 10 at 3. Even in such circumstances, the RMR Owner receives no additional payment for the provision of Ancillary Services. Tr. at 1408:5-6 (Le Vine). Accordingly, the costs of Ancillary Services dispatched pursuant to the RMR Contracts is not part of PG&E's RS costs and not a factor in this proceeding.

The ISO issues out-of-market ("OOM") calls under its authority to respond to existing, imminent, or threatened System Emergencies. Exh. ISO-1(Le Vine Direct Answering Testimony) at 8:8-20, 9:1-8. The ISO may only issue an OOM call if there are no available bids to meet the reliability need. Trial Stip. 10 at 5-6. The ISO Tariff does not limit the ISO's authority to issue an OOM call according to the cause of the System Emergency. *See* Trial Stip. 10 at 5-6, App. A at 15, 23-24. The ISO Tariff does, however, distinguish the entity responsible for the costs of an OOM call according to the cause of the call. If the OOM call is the result of a locational problem or a transmission facility outage, the costs are charged to the Participating Transmission

Owner in or adjacent to whose service area the locational problem or transmission facility outage occurred. Exh. ISO-1 at 9:16-20, 10:1-4; Trial Stip. 10, App. A at 46-41. Otherwise the costs are charged on a pro-rated basis to all Scheduling Coordinators. *Id.* Thus, the purpose of "local" OOM calls that would be included in PG&E's RS costs would be to resolve locational problems or transmission facility outages that cause or threaten a System Emergency. Exh. ISO-1 at 8:19 - 9:3, Tr. at 1434:5-15 (Le Vine).

Issue 5.B: Does ETC or TO Wholesale Transmission Service Cause the Need for RS?

Any particular Load cannot be identified as causing the need for RMR Generation and local OOM calls. Tr. at 1965:10-17 (Call), Tr. at 2010:24-25, 2011:1-6 (Call). As described above, the need for RMR Generation derives from the manner in which PG&E, as a vertically integrated electric utility, configured its transmission system. *See also,* Tr. at 2010:1-6 (Call). Because of that configuration, certain Loads are in transmission constrained areas, which the ISO has identified as local reliability areas. Exh. ISO-1 (Le Vine Direct Answering Testimony) at 5:8-19, Trial Stip. 6. RMR Generation is necessary at certain times to enable reliable transmission service to such Loads. Exh. ISO-1 at 5:8-19. From the Load's perspective, however, the designation of local reliability areas is serendipitous. Had the transmission system been configured differently, other Loads would constitute the transmission-constrained areas. Tr. at 2010:20-22 (Call). If PG&E had designed its transmission system differently, the Sacramento Municipal Utility District, the pumps of the Department of Water Resources, or any other Load could be in a local reliability area. There is no evidence that the PG&E's Loads in the local reliability areas participated in the design of PG&E's

transmission system *Cf.* Tr. at 2010:7-15 (Call) (implying that PG&E did not undertake to consult its retail customers as to the configuration of its transmission system) or benefited more from that design than other Loads. It is therefore not appropriate to single out Load within the local reliability areas as causing RMR costs. If the cause of RMR is to be attributed to Load, it should be attributed generally to all Load served by PG&E's transmission facilities.

Nonetheless, it can be said that a Load that had arranged for sufficient Generation and Transmission to meet its Demand does not contribute to the continued need for RMR Generation. Loads taking service under the PG&E's TO Tariff, however, cannot meet these criteria. The TO Tariff specifies rates for transmission provided pursuant to the ISO Tariff. The ISO Tariff does not distinguish firm from non-firm transmission; all transmission under the ISO Tariff is interruptible if there is congestion. Tr. at 1980:3-25, 1981:1-16 (Call); *see generally* Sections 7.2.4.1.1, 7.2.4.1.4, 7.2.5.2.7, Trial Stip. 10, App. A at 26-27, 29. Transmission service under the TO Tariff is therefore less firm than that provided under ETCs.

Under Section 9 of the ISO Tariff, the ISO does offer FTRs, a form of financial hedge against congestion that the Commission found comparable to firm transmission. *See California Ind. Sys. Operator Corp.*, 87 FERC ¶ 61,143, *reh'g denied* 88 FERC ¶ 61,156 (1999). FTRs also provide scheduling priority in the Day-Ahead Market, but no scheduling priority beyond that point. Further, while a transmission customer can reduce the likelihood of curtailment by submitting adjustment bids that attribute a high value to the transaction, there is no guarantee that another customer will not value the

transmission more highly. *See, generally*, Section 7.2.5 *et seq.* of the ISO Tariff. Trial Stip. 10, App. A at 29-27.

Wholesale customers taking service under the TO Tariff have no greater priority under the ISO Tariff than PG&E's use of its transmission service (also under the ISO Tariff) to serve its retail Load. *Id.*; Tr. at 2209:18-25, 2210:1 (Deters). Thus, if it could be said that wholesale TO Tariff customers, because they have TO Tariff transmission service available, do not cause the need for RMR Generation, then the same can be said for PG&E's retail customers. Either all users of PG&E's transmission facilities (except perhaps those with ETCs) cause the need for RMR Generation, or none do.

As discussed above, Local OOM calls can arise from a variety of transmission facility outages or local problems on the transmission system. Such events can rarely, if ever, be attributed to a particular Load. Accordingly, the question whether TO Transmission customers cause OOM calls is really a false issue.

Issue 5.C: Does RS Provide Benefits to ETC and/or TO Wholesale Customers?

As described above, RMR Generation is necessary in order for the ISO to serve Loads within local reliability areas. Hence, those Loads benefit directly from RMR Contracts.

Other users of PG&E's transmission facilities benefit more generally, however. Absent RMR Generation, the ISO would have to curtail firm Load in local reliability areas when Demand exceeds the combination of Generation within the area and transmission capacity into the area. Exh. ISO-1 (Le Vine Direct Answering Testimony) at 11:6-7. Human or mechanical error, however, can interfere with the prompt

curtailment of Load. Tr. at 1346:6-11 (Le Vine). Under such circumstances, facilities could become overloaded and fail, disrupting transmission well beyond the local reliability area. *Id.* Such local transmission failures cannot always be contained and have, in the past, occasionally led to cascading outages. Tr. at 1346:17-25, 1747:1-10 (Le Vine). Accordingly, RMR Generation, by reducing the likelihood of widespread transmission failures, benefits all users of PG&E's transmission failures.

Commission Trial Staff has properly identified an additional benefit to all users of PG&E's facilities. Exh. S-1 (Deters Prepared Answering Testimony) at 14:9-21. As described above, PG&E configured its transmission system in a least cost manner, avoiding the construction of transmission facilities when such could be avoided because of the location of Generation. This caused the creation of "load pockets." The avoidance of the construction of transmission facilities, however, also avoided the inclusion of the cost of those transmission facilities in PG&E's transmission revenue requirement. Exh. PGE-20 (Kozlowski Rebuttal Testimony) at 3:15-16. The result is lower rates for all users of PG&E's transmission facilities. The benefit is apparent if one considers the consequences if the ISO did not use RMR Contracts to provide local reliability. PG&E would then have to build transmission facilities to substitute for the RMR Contracts. The cost of those facilities would be included in the transmission revenue requirement that provides the basis for rates under PG&E's TO Tariff, increasing those rates. *See, e.g.* Tr. at 1491:24-25, 1492:1-10 (Helsby). Thus, all TO Tariff customers enjoy lower rates, and therefore benefit, because of RMR Generation.

Issue 5.J: Should TO Wholesale Customers Serving Loads Outside PG&E's Former Control Area Be Allocated a Portion of the RS Costs

The Loads to which PG&E proposes to allocate its reliability costs under its TO Tariff fall into one of two categories: those located within PG&E's former Control Area; and those that are outside PG&E's former Control Area. PG&E's former Control Area comprises those areas within or adjacent to (more properly, within or surrounded by) PG&E's Service Area. PG&E should assess its reliability costs only to those Loads within it former Control Area. The ISO's arguments relating to this issue are set forth in the discussion of Issue 5.M below.

Issue 5.M: Is PG&E's Proposed Allocation of RS Cost to Wholesale TO Tariff Customers Utilizing "Wheel-Out" or "Wheel-Through" Service for Load Outside PG&E's Control Area Permitted by the Commission's February 23, 2001, Order on Rehearing, San Diego Gas & Electric Co., Docket No. ER01-322-002, 94 FERC ¶ 61,200 (2001)?

In its February 23, 2001 order on rehearing in *San Diego Gas & Electric Co.*, 94 FERC ¶ 61,200 (2001) ("Order on Rehearing"), the Commission rejected arguments that San Diego Gas & Electric Company ("SDG&E") should charge RMR costs to all Loads that use its transmission facilities. The Commission explicitly stated that it would "not allow local RMR costs to be assigned to 'wheeling-out' and 'wheeling-through' service for load outside the ISO Control Area." *Id.* at 61,746. Moreover, the Commission concluded that this case constituted binding precedent in the ER00-2360 Docket and explained that parties to that proceeding are restricted to litigating the applicability of the Order on Rehearing to the facts of that case. *Id.*

PG&E has failed to identify affirmatively any circumstances sufficient to distinguish its proposal from the one rejected by the Commission in its Order on Rehearing. Moreover, on cross-examination, PG&E's witness Kozlowski acknowledged that wheeling under PG&E's TO Tariff was identical in all significant aspects to wheeling under SDG&E's TO Tariff. Tr. at 1081:22 - 1083:21 (Kozlowski). Therefore, PG&E's plan to allocate RS charges to wholesale transmission customers serving load outside of its former Control Area must be rejected.[2]

Nevertheless, the Order on Rehearing should not be interpreted as prohibiting PG&E from recovering RS costs from *any* of its wheeling customers; PG&E should still be able to allocate RS costs to wheeling customers serving load *within* PG&E's former Control Area. The Commission's statement in the Order on Rehearing that "the costs of RMR units located in [SDG&E's] service territory are [not] properly assigned to 'wheeling-out' and 'wheeling-through' customers," *id. at 61,745,* must be read in light of SDG&E's particular circumstances and the rationale of the Commission's order.

"Wheeling-out" and "wheeling-through" transactions involving SDG&E's Service Area, which are, by definition, transactions that serve load outside of the ISO Control Area:[3] SDG&E has no wheeling customers serving load within the

[2] Although there are areas within the ISO Control Area that are not within PG&E's former Control Area, PG&E does not propose to allocate RS costs to wheeling transactions that exit the ISO Controlled Grid within the Service Area of other Participating TOs. Exh. PGE-19 (Kozlowski Supplemental Testimony) at 2:11-19

[3] "Wheeling-out" is defined as the " use of the ISO Controlled Grid for the transmission of Energy from a Generating Unit located within the ISO Controlled Grid to serve a Load located outside the transmission and distribution system of a Participating TO. "Wheeling-through" is defined as the "use of the ISO

ISO Control Area. Tr. at 1082:5-25, 1083:1-9 (Koslowski). In the case of SDG&E, therefore, it is redundant to speak of "wheeling transactions leaving the ISO Control Area." The Commission's reference to wheeling transactions is therefore fully consistent with its later statement that it would prohibit "local RMR costs to be assigned to 'wheeling-out' and 'wheeling-through' service *for load outside the ISO Control Area*." 94 FERC at 61,746 (emphasis added). In the case of PG&E, for instance, some wheeling transactions do make use of PG&E's transmission facilities in order to serve load *within* the ISO Control Area.[4]

Indeed, prohibiting PG&E's allocation of RS charges to wheeling transactions within its former Control Area would be inconsistent with the Commission's rationale in *San Diego Gas & Electric Co.* The Commission stated that it would be improper to charge Loads outside the ISO Control Area because those Loads bear the analogous costs within their own Control Area. 94 FERC at 61,746. Loads within the ISO Control Area do not bear the reliability costs of any other Control Area. Therefore, although the Commission may find independent grounds for relieving PG&E TO Tariff wheeling customers within the ISO Control Area from the responsibility for RS costs, the Order in *San Diego Gas & Electric Co.* does not require such.

Controlled Grid for the transmission of Energy from a resource located outside the ISO Controlled Grid to serve a Load located outside the transmission and distribution system of a Participating TO."

[4] An example of such a transaction would be the delivery of Energy from a point outside the ISO Controlled Grid to serve Load in the Service Area of the Sacramento Municipal Utility District ("SMUD"). This would involve "wheeling" for the purposes of serving load *within* the ISO Control Area, because a) the transaction would utilize PG&E's transmission facilities, and b) SMUD's Service Area (and hence the Load served by the transaction) is within the ISO's Control Area. See, e.g. Tr. at 1280:1-11, 1284:10-14.

Issue 7.I: Should the ISO Be Responsible for Collecting the RS Charges?

PG&E has stated its intention that the ISO bill the RS charges on PG&E's behalf. Exh. PGE-1 at 22:9-17; Exh. PGE-19 at 1:18-22. The ISO opposes that proposal. The ISO Tariff does not currently provide for billing and collection services for any TO-specific charges that are contained in that TO's tariff. The responsibility, and cost, for collecting such charges appropriately belongs with the TO and should not be shifted to the ISO. Furthermore, the ISO's settlement process and software does not currently accommodate such TO charges. In order to bill the charges that PG&E proposes, the ISO would need to modify its existing software and add personnel resources. Exh. ISO-1 (Le Vine Direct Answering Testimony) at 15:6-15. For example, wheeling revenues are disbursed to PTO's according to their respective transmission revenue requirements in a given TAC Area. Exh. PGE-1 at 22:13-17. PG&E's proposal would involve an adder on the applicable Scheduling Points that the ISO is required to 'take off the top" and give solely to PG&E. See Exh. PGE-1 at 22:18-23, 23:1-5. Such administrative costs would be borne by all Scheduling Coordinators through the ISO's Grid Management Charge. These additional costs cannot be justified, and should certainly not be spread to the entire market.

III. CONCLUSION

WHEREFORE, the California ISO requests that the Presiding Judge rule on the issues in this proceeding in accordance with the discussion above.

Respectfully submitted,

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Dated: April 13, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the restricted service list compiled by the Presiding Administrative Law Judge in the above-captioned proceeding.

Dated at Washington, D.C. this 13th day of April, 2001.

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Michael Kunselman