

APPENDIX



February 20, 2002

Joel D. Newton
Sr. Director and Regulatory Counsel
Dynergy Power Marketing, Inc.
1500 K Street, N.W., Suite 400
Washington, DC 20005

Dear Mr. Newton:

I am writing in response to your letter of February 12, 2001, to Charles Robinson, concerning \$29.6 million allegedly owed to Dynergy Power Marketing, Inc. ("Dynergy") for power sold to the California Department of Water Resources ("CDWR") during the period of January 17 through 31, 2001. Specifically, this letter details why the payment made to Dynergy is its proper share of the total amounts received by the ISO for the month of January, 2001. I also explain how the settlement procedures for January, 2001 comply with the ISO Tariff, the Federal Energy Regulatory Commission ("Commission") order of November 7, 2001, concerning CDWR obligations for energy transactions on behalf of Southern California Edison Company ("SCE") and Pacific Gas & Electric Company ("PG&E") (collectively, the "IOUs") and the ISO's November 21, 2001 filing made in compliance with the November 7 order.

The total market amounts invoiced by the ISO for all market transactions in January, 2001 was \$896,431,365.79, with CDWR invoiced \$155,614,362.93 for the period January 17 through 31, 2001. The ISO received \$170,516,117.83 from all debtors and, as required, disbursed funds pro rata to all Market Participants who were ISO Creditors for the Trade Month of January, 2001. Dynergy is owed \$160,546,000.47 for January, 2001, and received its pro rata share of \$36,919,457.35. The legal requirements for the settlement of receivables and pro rata disbursements are as follows.

The ISO Tariff Section 11.9 provides that the ISO is to invoice Scheduling Coordinators on a monthly basis and establishes that each such invoice is to be paid in accordance with the ISO Payment Date. The ISO Payment Calendar, a public document, sets forth Payment Dates by Trade Months, and, so establishes that the ISO Settlement system is based upon Trade Months.

It appears you have confused the specificity of the Trade Day, and even operating hour, for which a Scheduling Coordinator is liable with the settlement of ISO Creditor accounts by Trade Month. Scheduling Coordinators are liable for debts accrued on specific Trade Days and operating hours. Thus, CDWR became liable for debts accrued on and after Trade Day January 17, 2001, in accordance with the terms of State law AB1X and the Commission's

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November 7 order. For example, this is the same as when, on April 6, 2001, PG&E filed for bankruptcy, the ISO invoiced the former PG&E Scheduling Coordinator for the Trade Days of April 1 through 6, up to a specific hour, and then began to invoice the new Scheduling Coordinator for the post-petition PG&E entity for all periods thereafter. The ISO, however, in accordance with the ISO Tariff, disbursed funds remitted by the former and new PG&E Scheduling Coordinators, along with all other receivables for the month, to ISO Creditors for that Trade Month of April, pro rata as required. As additional examples, the ISO switched invoices on specific Trade Days to different Scheduling Coordinators for both the California Power Exchange and Enron Energy Services, Inc, to accord with their respective filings of bankruptcy petitions. Again, however, the ISO disbursed funds to ISO Creditors on a pro rata basis within the respective Trade Months as a whole.

In its November 7 Order, the Commission directed the ISO to enforce its billing and settlement procedures and invoice CDWR for its spot market transactions on behalf of the IOUs. Critically, California State law AB1X contemplates CDWR undertaking such financial obligations on January 17, 2001, and not before. In its November 21 compliance filing, the ISO indicated that a slightly modified settlement process was required because the ISO Settlements and Billing Protocol Section 6.10.4 provides that the "ISO shall apply payments received in respect of amounts owing to ISO creditors to repay the relevant debts in the order of the creation of such debts." Thus, the ISO proposed to apply CDWR payments first "to the month remitted," then to February through July and finally, to January. ISO Compliance Filing at 13. The ISO provided an example wherein CDWR June 2001 payment is applied to the CDWR June 2001 invoice. *Id.* As always, the crediting of funds received from CDWR to satisfy CDWR accounts is separate and distinct from the ISO disbursement of funds received in any given Trade Month.

In proposing a modified settlement process for CDWR, the ISO did not seek exemption from the underlying Trade Month foundation for disbursements, pro rata where required, to ISO Creditors. The ISO follows its Tariff in disbursement to satisfy ISO Creditors, by allocating sums received, pro rata if required, to the oldest unpaid debts, but in the case of CDWR, starting with February, advancing through July, and then to January, 2001. Nowhere has the ISO ever contemplated a split within a Trade Month for disbursement of funds to ISO Creditors. The ISO would require Commission approval for such a departure from the Tariff requirements, and neither has the ISO sought such approval nor has the Commission ordered it.

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Moreover, ISO Tariff Section 11.13 requires the ISO to calculate the amounts available for distribution to ISO Creditors on Payment Dates, while Tariff Section 11.16.1 and ISO Tariff Settlements and Billing Protocol Section 6.7.4 collectively provide that if there are insufficient funds for the ISO to pay all ISO Creditors in full, the ISO is to reduce payments to all ISO Creditors proportionately to the net amounts payable to them. Thus, the ISO makes payments based upon Trade Months, and reduces pro rata such payments in the event of insufficient funds to fully pay all accounts owed within a Trade Month. This the ISO did for the January, 2001 market (and as concerns months in which CDWR is the Scheduling Coordinator for the IOUs, the ISO disbursed funds pro rata for the July and August, 2001 markets as well).

In closing, I note that you appear to be under a misunderstanding regarding ISO invoicing by charge type as opposed to total transactions by Trade Month. You appear to believe that Dynegy should be reimbursed on a service or product-specific basis, further specified by Trade Day. The ISO Tariff requires, to the contrary, that invoices be based on the Preliminary Settlement Statements and Final Settlement Statements, with each invoice showing amounts to be paid by or to each Scheduling Coordinator and the Payment Date, *i.e.*, the date on which such amounts are to be paid or received. Tariff Section 11.9. Absent permission from the Commission, the ISO is prohibited from invoicing CDWR, Dynegy, or any other Market Participant on a charge type basis.

I hope this letter helps you to understand that Dynegy has received a proper payment for the month of January, 2001.

Very truly yours,

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