address the deficiencies identified by the PX. The ISO requests that the Commission defer ruling on this particular matter pending further discussions between the ISO and the PX to determine if the revised DUC software does in fact address the concerns raised by the PX.

DWR raises concerns that the creation of Zone 26 and the potential application of the DUC to Zone 26 may significantly increase costs to DWR. *Id.* at 8-10. DWR raise no specific concerns about the ISO's DUC methodology other than that the costs incurred for use of the transmission paths into and out of Zone 26 may be high. DWR raises no substantive issues concerning the ISO's DUC methodology and therefore has established no basis for its requests that the Commission institute an investigation of the DUC. Therefore, DWR's request should be rejected.

L.3. With respect to the ISO's Neutrality Adjustment:

a. Is the ISO's Neutrality Adjustment sufficiently defined and should it be included as a formula rate in the ISO Tariff?

b. Should there be a cap on the amounts that can be collected?

c. What items are properly included in the Neutrality Adjustment?

d. How should the charges be allocated?

[Issue Nos. 204, 208, 229, and 304, Docket Nos. EC96-19-021 and ER96-1663-022, and Issue No. 403, Docket No. ER98-3760-000. Proponents - Dynegy, Southern Cites, Cities / M-S-R, and City of Vernon, California ("Vernon")]

Proponents make four arguments concerning the ISO's neutrality adjustment. First, they assert that the neutrality adjustment should not be accepted as a formula rate in the ISO Tariff, because the ISO has not disclosed to stakeholders the data inputs used to calculate the neutrality adjustment.

Joint Initial Brief on Issue L.3, at 3. Second, Proponents argue that if the Commission does allow a formula treatment, it should place a cap of two mills per kWh on the amounts that can be collected, and once the cap is reached the ISO should be required to file with the Commission a proposal to collect additional amounts. Proponents claim that a cap is appropriate because it "will allow certain flexibility" in assessing the charges related to the neutrality adjustment, which are numerous and difficult to verify. *Id.* at 3-4. Third, Proponents assert that the ISO should prepare a report on the neutrality adjustment and its proposed allocation of related charges, because a more detailed allocation methodology is appropriate. *Id.* at 4. Fourth, Proponents argue that costs related to UFE should be excluded from the neutrality adjustment with regard to municipal utilities. Proponents' reasoning is as follows: (1) UFE mainly involves distribution-related costs; (2) municipal utilities bear all of their own UFE-related costs and do not cause the UFE charges which arise from retail service outside their systems; (3) therefore, municipal utilities will be improperly double-charged if assessed an "inapplicable amount of UFE costs" through the neutrality adjustment. *Id.*

As discussed below, Proponents' criticisms fail to withstand scrutiny. The neutrality adjustment is a reasonable means of settling cash imbalances. Moreover, in the revised transmission Access Charge filing, which was filed on March 31, 2000 in Amendment No. 27, the ISO is proposing that total annual charges levied under the neutrality adjustment, as described in Section 11.2.9 of the ISO Tariff, will not exceed $0.095/MWh, applied to gross Loads in the ISO Control Area and total exports from the ISO Controlled Grid unless approved by

the ISO Governing Board. In addition, the ISO has already committed to study potential actions that can be taken to reduce the neutrality adjustment. Finally, the question of the proper allocation of UFE costs is discussed in connection with Issue L.5, below.

Proponents are correct that the original intent of the neutrality adjustment was to collect for cash imbalances due to rounding. *See* Joint Initial Brief on Issue L.3, at 5. In Amendment No. 6 to the ISO Tariff the ISO filed to expand the items included in the neutrality adjustment. The ISO noted that additional cash imbalances were identified during testing and market simulations conducted prior to the ISO Operations Date. As identified by the ISO in Amendment No. 6, such imbalances were the result of the following:

- Control Area inadvertent Energy interchanges that are the result of the fact that import and export Schedules at the tie-points are "deemed" delivered. Due to the multiple Schedules at each tie it is not possible to disaggregate hourly flows and assign them to specific Schedules. In actuality, while Schedules are "deemed" satisfied, aggregate imbalances do exist at the ties due to inadvertent flows.

- Real-time Inter-Zonal Congestion can result in cash imbalances. Real-time Inter-Zonal Congestion requires the ISO to Dispatch resources in the importing and exporting Zones and to the extent that payments do not match, imbalances will result.

- Transmission Losses are components of both Import Deviation and UFE. Losses for import deviations are calculated based on scheduled imports. However, losses for UFE are calculated based on actual deliveries at the tie points. Therefore, two different losses quantities are calculated. Any difference between the two results in a cash neutrality mismatch.

- Imbalances in forward market Schedules can occur when the sum of scheduled Generation, imports, Loads, exports and inter-Scheduling Coordinator trades is not zero yet falls within the ISO's 1-20 MW Balanced Schedule deviation tolerance; and

- Differences that may result from the settlement of instructed and uninstructed deviations. Under the ISO's market design, resources are paid different amounts for deviations from Schedules instructed by the ISO and deviations from Schedules that were not instructed (uninstructed) by the ISO.[178]

In Amendment No. 22, the ISO proposed and the Commission accepted additional revisions to Section 11.2.9 of the ISO Tariff. *See California Independent System Operator Corporation*, 89 FERC at 61,686-87. The ISO stated that as an entity that collects no monies on its own account (except for operating expenses), the ISO's role in the settlement process is primarily as a clearinghouse for Market Participants.[179] The ISO noted that, in most cases, when a Scheduling Coordinator disputes a Preliminary Settlement Statement and the dispute is granted, the ISO adjusts for the disputed amount in all Scheduling Coordinator Final Settlement Statements for the applicable period, but that, when the dispute is denied and the Scheduling Coordinator pursues the options of good faith negotiation or Alternative Dispute Resolution ("ADR") procedures, the ISO may find itself in the position of owing additional monies to that Scheduling Coordinator, to be paid for by other Scheduling Coordinators, or of receiving additional revenue from that Scheduling Coordinator, to be credited to other Scheduling Coordinators. In Amendment No. 22, the ISO was authorized to allocate amounts payable by or to the ISO pursuant to good faith negotiations or the ADR process to other Scheduling Coordinators through the neutrality adjustment. *California Independent System Operator Corporation*, 89 FERC at 61,686-87.

Proponents contend that the neutrality adjustment should not be accepted as a formula rate. Joint Initial Brief on Issue L.3, at 3. Proponents argue that a

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[178] Amendment No. 6 filing, Docket Nos. EC96-19-021 and ER96-1663-022 (Mar. 23, 1998), at 70-71.

[179] Funds that the ISO receives from one Market Participant are passed on to another Market Participant or Participants. Changes in a charge to one Scheduling Coordinator require offsetting changes in charges or credits to other Scheduling Coordinators.

formula rate can only be approved if "the formula can clearly be applied and the data which comprise the inputs to the formula are easily and accurately identifiable." *Id.* at 7. However, it should be noted that all the cases Proponents adduce in support of this proposition involve the rates of investor-owned utilities. In contrast to these entities, however, the ISO is a non-profit customer service organization whose role in the settlement process is primarily as a clearinghouse for Market Participants. Consequently, any charges or credits accruing to the ISO must somehow be passed through to the Market Participants. The only question is how such pass-through should be accomplished.

In fact, the ISO *has* provided a "formula that can clearly be applied," as well as "data which comprise the inputs" for the neutrality adjustment. Thus, the ISO has precisely defined the charges/credits that will be added together to equal the neutrality adjustment. *See* ISO Tariff, Section 11.2.9. Each of these charges/credits is in turn a residual resulting from the computation of a quantity whose computation is precisely expressed in the ISO Tariff (i.e., Inter-Zonal Congestion, losses, etc.). The result of the application of this addition has been a precise dollar amount calculated for each month. The results of the calculation of the neutrality adjustment for each of the months in 1999 are shown in Table 1, below.

However, Proponents apparently wish the ISO to do more. They do not argue with the proposition that the ISO can and should pass through charges and credits to Market Participants. Instead, they appear to demand that the ISO eliminate all residuals in its calculations of various quantities, and allocate each dollar to the appropriate Market Participant. Joint Initial Brief on Issue L.3, at 16-17. Proponents do not consider whether a system that chases down and accounts for every last dollar of Congestion, losses, inadvertent interchange Energy, UFE, and Schedule deviation cost can be technically feasible or

cost-effective. In fact, such a system, even if it could be constructed, would result in Market Participants paying far more to reimburse the ISO for its operational costs than they are now. The ISO has formulated its neutrality adjustment with as much precision as to computation and data as is possible under the current system. It is worth noting that the Commission has approved similar residual charges spread over classes of Market Participants. *See, e.g.*, *New England Power Pool*, 87 FERC ¶ 61,045, 61,193 (1999); *New England Power Pool*, 85 FERC ¶ 61,379, 62,463 (1998).

Finally, the residual amounts spread on a pro rata basis among Market Participants by the neutrality adjustment are small when compared to the market costs at issue. For example, as shown in Table 1, below, the average monthly neutrality adjustment for 1999 was less than $900,000. The amount was never more than 0.7% and typically well below 0.5% of the ISO's gross monthly billings.

Table 1
Neutrality Adjustment 1999 (millions)

Month	Neutrality (Million)	Gross Dollars (Million)
January-99	$ 0.24	$ 242
February-99	$ 0.54	$ 189
March-99	$ 0.39	$ 243
April-99	$ 0.07	$ 299
May-99	$ 1.23	$ 279
June-99	$ 1.44	$ 229
July-99	$ 0.95	$ 403
August-99	$ 2.43	$ 504
September-99	$ 2.18	$ 477
October-99	$ 2.63	$ 783
November-99	$ -2.34	$ 595
December-99	$ 0.79	$ 450

Proponents also argue that there should be a cap of two mills per kWh on the amounts collected through the neutrality adjustment and state that the ISO should be required to file with the Commission any proposal to collect neutrality adjustments in excess of the established limits. *See* Joint Initial Brief on Issue L.3, at 10-12. It would be inappropriate to subject the ISO, an entity that serves as a clearinghouse for Market Participants, to such a "hard cap" on the recovery of neutrality adjustments.

In Amendment No. 27, as part of the revised transmission Access Charge methodology, the ISO has proposed that total annual charges levied under the neutrality adjustment, as described in Section 11.2.9 of the ISO Tariff, will not exceed $0.095/MWh, applied to gross Loads in the ISO Control Area and total exports from the ISO Controlled Grid, unless the ISO Governing Board reviews the basis for the charges above that level and approves the collection of charges above that level for a defined period and the ISO provides at least seven days' advance notice to Scheduling Coordinators of the determination of the ISO Governing Board.

As explained above, the ISO does not believe that an absolute cap on the neutrality adjustment is appropriate. The ISO is a cash-neutral entity. To the extent that Market Participants are responsible for paying certain costs, the ISO must be able to allocate such costs to Market Participants and collect the full amount. The ISO believes that its proposal is superior to a requirement that it be forced to make a separate Section 205 filing to account for unanticipated increases in the neutrality adjustment. Under the ISO's proposal in Amendment No. 27, stakeholders are fully informed of the amount of any increase in the neutrality adjustment and the basis for such an increase. To the extent that they disagreed with the ISO Governing Board's decision that it is

appropriate to recover these costs through the neutrality adjustment, they would be free to challenge that determination before the Commission.

Proponents request that the Commission order the ISO to prepare an analysis that identifies with specificity the level of the neutrality adjustments, the utilities in whose Service Area these costs are being incurred, the categories of cost, and a proposal for an equitable allocation of the costs. Joint Initial Brief on Issue L.3, at 17. The ISO notes that it has already committed, as part of the Unresolved Issues settlement concerning the resolution of Unresolved Issue No. 243, to undertake a review of what actions can be undertaken to reduce the neutrality adjustment. The ISO is to publish the results of its review and provide interested parties with an opportunity to comment on the report. The ISO is currently preparing the report.

Proponents also repeat their arguments as stated in relation to Issue L.5, that UFE should be excluded from the neutrality adjustment with regard to municipal utilities. *See* Joint Initial Brief on Issue L.3, at 13. Proponents' reasoning is as follows: (1) UFE mainly involves distribution-related costs; (2) municipal utilities bear all of their own UFE-related costs and do not cause the UFE charges which arise from retail service outside their systems; (3) therefore, municipal utilities will be improperly double-charged if are assessed an "inapplicable amount of UFE costs" through the neutrality adjustment. *Id.*

It is not clear to the ISO whether Proponents assume that UFE is included in the neutrality adjustment or whether they have concerns about the Transmission Losses calculation related to UFE. In any case, the issue is discussed in relation to Issue L.5, pertaining to whether UFE should be allocated to municipal entities. As stated in connection with Issue L.5, the calculation and allocation of UFE have been improved since the ISO Operations Date. In addition, the ISO Tariff clearly requires UFE to be calculated for each UDC

Service Area. Any entity meeting the definition of a UDC can qualify for a separate UFE calculation for its Service Area by signing a UDC Agreement with the ISO.

In sum, Proponents have not demonstrated that the neutrality adjustment is unjust or unreasonable. While the ISO is preparing a report that is intended to identify additional improvements that can be made to reduce these charges, Proponents have not justified modification of the current ISO Tariff provisions.

L.4. With regard to Metered Subsystems, Existing Contracts, or non-converted transmission contracts, should SP 4.2.1(c) and SBP 2.2.2 be revised to recognize that transmission losses may be dealt with by a scheduling party's system according to existing protocols in use for those contracts and not according to ISO protocols? [Issue No. 80, Docket Nos. EC96-19-008 and ER96-1663-009 and Issue No. 347, Docket Nos. EC96-19-006, EC96-19-008, ER96-1663-007, and ER96-1663-009. Proponents - SMUD and MWD]

Proponents raise two issues with respect to the calculation of losses. First, they argue that, with respect to a Metered Subsystem, the GMM, which is the mechanism through which the ISO determines the amount of Demand that can be served by a Generator, after losses on the ISO Controlled Grid are taken into account, should be calculated "at the perimeter of the MSS" or of the Scheduling Coordinator that represents the customer operating as a Metered Subsystem. Joint Initial Brief on Issue L.4, at 2-3. They also argue that, where a Scheduling Coordinator represents an entity with Existing Rights or "Non-Converted Transmission Contracts," the same principle should apply and, in addition, the ISO should calculate losses based on the contract that gave rise to those rights, rather than in accordance with the methodology in the ISO Tariff. *Id.* at 3. They propose changes to Section 4.2.1(c) of the SP to implement these