

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

<b>Cities of Anaheim, Azusa,</b>	)	
<b>Banning, Colton, and</b>	)	
<b>Riverside, California</b>	)	
	)	
<b>v.</b>	)	<b>Docket No. EL00-111-____</b>
	)	
<b>California Independent System</b>	)	
<b>Operator Corporation</b>	)	

**REQUEST FOR REHEARING OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION**

The California Independent System Operator Corporation (“ISO”)<sup>1</sup> respectfully submits this request for rehearing of certain aspects of the Commission’s Order Dismissing in Part and Granting in Part Complaint issued on March 14, 2001 in the above-captioned docket, 94 FERC ¶ 61,268 (“March 14 Order”), pursuant to Section 313(a) of the Federal Power Act, 16 U.S.C. § 825l(a) (1994), and Rule 713 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2000).

**I. SUMMARY OF POSITION**

In the March 14 Order, the Commission has erroneously determined that that the neutrality adjustment charge cap under Section 11.2.9.1 of the ISO Tariff should be applied on an hourly rather than an annual basis. The vast majority of

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<sup>1</sup> Capitalized terms not otherwise defined herein are used in the sense given the Master Definitions Supplement, Appendix A to the ISO Tariff.

the evidence – including the intent of the ISO Governing Board, the purpose of the neutrality adjustment charge, the ISO’s functions, the ISO’s status as a not-for-profit and revenue-neutral entity, the standard use of MWh as a basic unit of measure, how the cap has in fact been applied, and the damage that would result from applying an hourly cap rather than an annual cap – all indicates that the cap was always intended to be annual and indeed has been applied on an annual basis. Thus, the evidence demonstrated that the cap in Section 11.2.9.1, both as originally proposed by the ISO and as accepted by the Commission, has always been annual in nature. The omission of the word “annual” from that section is a mere administrative or clerical error meriting simple correction and nothing further. Failure to recognize the annual nature of the cap would leave the ISO without an explicit mechanism for recovery of a portion of the “neutrality costs” incurred on behalf of Market Participants and would be contrary to the Commission’s recognition of the ISO as a revenue-neutral, non-profit entity that must collect its costs from those entities that use the ISO Controlled Grid.

## **II. SPECIFICATIONS OF ERROR**

The ISO respectfully submits that the March 14 Order errs in the following respects:

1. The Commission’s determination that the neutrality adjustment charge cap under Section 11.2.9.1 of the ISO Tariff should be applied on an hourly rather than an annual basis, is contrary to the nature of that cap as previously proposed and accepted by the Commission . The vast majority of the evidence indicates that the

cap should be applied on an annual basis. Therefore, the Commission's determination was arbitrary, capricious, and an abuse of discretion.

2. Application of neutrality adjustment charge cap under Section 11.2.9.1 of the ISO Tariff on an hourly basis would improperly leave the ISO's without an explicit mechanism for recovery of certain costs incurred on behalf of Market Participants and would be contrary to the Commission's recognition that the ISO is a revenue-neutral non-profit entity that must recover all costs from Market Participants.

### **III. BACKGROUND**

#### **A. The Neutrality Adjustment Charge Cap**

The ISO is a revenue-neutral entity, authorized under the California electric industry restructuring legislation and Commission precedent to recover its costs from the Market Participants on whose behalf it operates the Ancillary Service and Imbalance Energy markets. To maintain revenue-neutrality, the ISO must maintain an accounting balance of zero in the Settlement process. Revenue-neutrality requires, among other things, a balancing of costs incurred by the ISO for out-of-market purchases against Market Participant payments of such costs incurred.<sup>2</sup> Thus, Scheduling Coordinators are assessed a neutrality

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<sup>2</sup> See ISO Tariff, § 11.2.9. In-state out-of-market calls are settled according to Section 11.2.4.2.1 of the ISO Tariff and out-of-state out-of-market calls are based on negotiated prices.

adjustment charge to thereby defray ISO costs for out-of-market purchases made to ensure system reliability on behalf of Market Participant Load.<sup>3</sup>

When the ISO is required to purchase necessary energy through out-of-market purchases, the neutrality adjustment charge is the sole mechanism through which the costs of such purchases are allocated to Scheduling Coordinators. These costs are not recoverable through other provisions of the ISO Tariff. Authority for the neutrality adjustment charge is granted in the ISO Tariff at Section 11.2.4.2.1.

As part of the development of the ISO's Transmission Access Charge , the ISO considered proposals to establish a flexible cap on neutrality adjustments. The costs to be recovered through the neutrality charge can vary greatly from hour to hour. An hourly cap on the charge would need to be quite high in order to account for this volatility. Only by basing an estimated cap on the largest practicable sample size, or time period, can the ISO and Scheduling Coordinators have statistical assurance of the reasonable accuracy of the estimate. To avoid this problem, the ISO determined that an annual basis afforded a higher degree of certainty and accuracy in estimation of the neutrality adjustment charge. The Tariff language approved by the ISO Governing Board to implement this concept therefore appropriately referred to an "annual" cap that could be modified by action of the ISO Governing Board.

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<sup>3</sup> See Cal. Pub. Util. Code § 365(a) (West 2000); *Pacific Gas and Electric Company, et al.*, 81 FERC ¶ 61,122, at 61,459 (1997). See also March 14 Order at 61,934 ("Regarding the ISO's contention that there is no basis for requiring it to absorb the costs for maintaining system reliability, we agree."); *California Independent System Operator Corporation*, 94 FERC ¶ 61,266, at 61,928 (2001) ("The ISO is a non-profit entity and there is no basis for requiring the ISO to absorb these neutrality costs on a month-to-month basis when the ISO's charges are designed to collect its revenue requirement on an annual basis.") ("Amendment No. 35 Order").

As part of Amendment No. 27 to the ISO Tariff, which was submitted on March 31, 2000 and proposed a new method for the determination of transmission Access Charges, the ISO filed Section 11.2.9.1 to the ISO Tariff to cap the level of the neutrality adjustment charge. Due to an administrative error, the word “annual” was inadvertently omitted from the version of Section 11.2.9.1, as submitted in Amendment No. 27, which read as follows:

The total charges levied under Section 11.2.9 shall not exceed \$0.095/MWh, applied to Gross Loads in the ISO Control Area and total exports from the ISO Controlled Grid, unless: (a) 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 (b) the ISO provides at least seven days’ advance notice to Scheduling Coordinators of the determination of the ISO Governing Board.

The Commission accepted Amendment No. 27, including Section 11.2.9.1, effective June 1, 2000, suspended it, and set it for hearing, which is held in abeyance pending efforts at settlement.<sup>4</sup>

Acting under authority of Section 11.2.9.1, on September 7, 2000, the ISO Governing Board approved an increase to the annual limit of total charges levied under Section 11.2.9 from \$0.095/MWh to \$0.35/MWh for the period of September 15, 2000 through January 15, 2001.

On December 29, 2000, as part of Amendment No. 35 to the ISO Tariff, the ISO proposed to correct the wording of Section 11.2.9.1, explaining that:

The version of Section 11.2.9.1 approved by the ISO Board for inclusion in Amendment No. 27 indicated that the provision would be applicable to total neutrality charges on an annual basis. Due to an administrative error, the Tariff language submitted in Amendment No. 27 omitted the reference to the annual period. As shown in Attachment J to [that] filing, the ISO now proposes to

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<sup>4</sup> *California Independent System Operator Corporation*, 91 FERC ¶ 61,205 (2000).

correct this error, by adding the word “annual” to Section 11.2.9.1 as approved by the Board.<sup>5</sup>

In the Amendment No. 35 Order, the Commission accepted the ISO’s correction, based in part on the rationale that “it is clear from the draft language approved by the ISO Board, that the Board intended to cap the neutrality charge on an annual basis.”<sup>6</sup> This is precisely true, because the intent of the annual cap was always to permit Scheduling Coordinators to estimate the total dollars they will pay annually through the neutrality charge. The ISO intends that a total dollar amount is to be identified and then, if the ISO comes within ten percent (10%) of the total, an adjustment will be made to ensure that the ISO collects enough to defray the costs of neutrality and remain revenue-neutral. In the Amendment No. 35 Order, the Commission affirmed this determination by the ISO that the cap, from inception, has always been and is an annual cap.

**B. The Southern Cities Complaint and the March 14 Order**

On September 15, 2000, the Southern Cities filed their complaint in the above-captioned docket. Relevant to the present proceeding, the Southern Cities argued that the ISO violated Section 11.2.9.1 by imposing neutrality adjustment charges in excess of the cap established in that section without completing proper procedures. The Southern Cities’ argument was based on the contention that Section 11.2.9.1 should be applied on an hourly basis. As relief, the Southern Cities asked the Commission to require the ISO to abide by the purported hourly cap on neutrality adjustment charges in Section 11.2.9.1, and to

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<sup>5</sup> Transmittal Letter for Amendment No. 35 Filing, Docket No. ER01-836-000 (Dec. 29, 2000), at 11.

<sup>6</sup> Amendment No. 35 Order at 61,928.

refund neutrality adjustment charges in excess of that cap during the period of June 1, 2000 through September 15, 2000. The Southern Cities complaint also raised certain issues associated with the ISO's allocation of costs of out-of-market purchases.

The ISO filed an answer to the Southern Cities' complaint, in which the ISO explained that Section 11.2.9.1 properly should be applied on an annual rather than an hourly basis. An annual basis is consistent with the purpose of the neutrality adjustment charge cap, the explicit language approved by the ISO Governing Board in approving the cap, and is part of the rationale the Commission employed in accepting Amendment No. 35, which corrected the prior administrative omission of the term "annual" in the initial filing of the neutrality adjustment charge cap. The ISO also filed other pleadings in response to other parties' motions in the same docket. The ISO filed these other pleadings on October 10 and 30, 2000.

In the March 14 Order, the Commission dismissed those parts of the Southern Cities complaint that had to do with the ISO's allocation of the costs of out-of-market purchases.<sup>7</sup> However, as to the neutrality adjustment charge cap, the Commission found in favor of the Southern Cities. The Commission first reasoned that the language of Section 11.2.9.1 does not include language to support applying the cap on an annual basis, while noting that "[t]he provision also does not include language indicating that the limit . . . is not intended for

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<sup>7</sup> See March 14 Order at 61,934. Because the ISO does not dispute this aspect of the Commission's determination, the present filing omits discussion of the cost allocation methodology.

application on an hourly basis.”<sup>8</sup> The Commission also stated that “the ISO is attempting to apply an annual neutrality cap to a limited three and a half month period.”<sup>9</sup> The Commission therefore determined that the application of Section 11.2.9.1 on an annual rather than an hourly basis represents “a substantive change” to that section that should not be applied retroactively.<sup>10</sup> Concurrently with the March 14 Order, the Commission issued the Amendment No. 35 Order.<sup>11</sup>

#### **IV. ARGUMENT**

The ISO previously has explained that the recovery of costs on an annual basis under Section 11.2.9.1 accomplishes all of the following: (1) ensures the ability of the ISO to recover costs which might not otherwise be recoverable through other provisions of the Tariff; (2) provides Market Participants with a measure of the projected costs on an annual basis; (3) provides an explicit means through which the ISO will monitor the amounts being billed through neutrality; and (4) is based on a proper understanding of Section 11.2.9.1, Section 11.2.9 generally, the intent of the ISO Governing Board, and the cost recovery mechanisms provided for in the California electric industry restructuring legislation and Commission precedent.<sup>12</sup>

In short, the only reasonable construction of Section 11.2.9.1 is that the ISO should recover neutrality adjustment costs on an annual basis. As

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> See Amendment No. 35 Order at 61,928.



discussed below, Southern Cities' interpretation, by contrast, is unjust, unreasonable, and unsupported by the facts.

For the reasons which the ISO has previously described, as well as for all the reasons discussed below, the Commission should grant the ISO's request for rehearing, and should conclude that the neutrality adjustment charge cap should be applied on an annual rather than an hourly basis.

**A. The Commission Misconstrues the Reason That the Neutrality Adjustment Charge Cap Is Calculated In "Per Megawatt-Hour" Units**

In the March 14 Order, the Commission relied on the wording of Section 11.2.9.1 as a rationale for stating that the cap is hourly rather than annual. However, the Commission found only that Section 11.2.9.1 does not include language requiring application of the neutrality charge on an annual basis, and that "[t]he provision also does not include language indicating that the limit . . . is not intended for application on an hourly basis."<sup>13</sup> Also in the March 14 Order, the Commission, writing that "the limit – which, we note, is stated using a 'per megawatt-hour' unit," appeared to conclude that because the unit in which the cap is based is that of MWh, somehow the ISO must apply the cap on an hourly and not annual basis. This is not correct.

Megawatt-hour units form the basis of most of the ISO settlement systems. All billing determinates for energy, including neutrality charges, are expressed as MW per hour or MWh. This is the very basis of the ISO's and all

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<sup>12</sup> See Answer of the California Independent System Operator Corporation to Complaint of the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California, Docket No. EL00-111-000 (Sept. 25, 2000), at 7-12.

<sup>13</sup> *Id.*

Market Participants' business systems for tracking, scheduling, invoicing, and settling electric energy transactions. The core unit of MWh is used in a wide range of calculations to reach daily, monthly, and annual quantification of all sorts of electricity transactions.

The ISO, therefore, as a matter of standard industry practice, uses MWh as the unit in which the annual cap for the neutrality adjustment charge is expressed. Scheduling Coordinators, each of whom has a variable volume of energy, multiply the MWh cap by their specific volumes to reach their specific charge amounts.

Further, contrary to the Commission's inference, there is no relationship between the use of MWh as the unit for expressing the cap and the application of the cap on an annual basis. The rationale for Amendment No. 27 was to provide to Scheduling Coordinators and potential market participants cost estimates and annual charge data for use in their annual budget projections. This is the proposal approved by the Governing Board as reflected in a Board memorandum available to all Market Participants, including the Southern Cities. This Board memorandum was filed as an attachment to the ISO's Answer in this proceeding. Budgets are customarily conducted on an annual basis, and the annual basis for the neutrality adjustment charge conforms with that standard business practice. Ease of calculation dictates use of MWh as the unit but standard business practice, ISO settlement systems, and the need to provide accurate estimates dictate use of an annual basis for the cap. Thus the Commission is incorrect in

assuming, merely because the core unit for the cap is MWh, that an hourly basis is intended, inferred, implied, or required.

**B. Even Assuming That the Language of Section 11.2.9.1 Is Ambiguous, Proper Interpretation of the Language Requires Due Consideration of Intent**

**1. The Commission Has Recognized That the Cap Was Intended to Be Applied On An Annual Basis**

As explained above, the word “annual” was not included in Section 11.2.9.1, as originally submitted in Amendment No. 27, due to an administrative error. Moreover, as the Commission recognized, the ISO Governing Board *intended* to cap the neutrality adjustment charge on an annual basis when the Board originally approved Section 11.2.9.1. The Commission has acknowledged that the neutrality adjustment charge cap was envisioned – from well before the time that Amendment No. 27 was submitted – as an annual cap: “[I]t is clear from the draft language approved by the ISO Board, that the Board intended to cap the neutrality charge on an annual basis.”<sup>14</sup> Applying the cap on an annual basis is the only way to give effect to the intentions of the ISO Governing Board and the Market Participants that supplied input as to the content of Section 11.2.9.1. Additionally, the result of these entities’ deliberations provided notice that Section 11.2.9.1 was intended to implement an annual cap.

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<sup>14</sup> Amendment No. 35 Order at 61,928. Additionally, the Commission rejected Southern Cities’ argument that the neutrality cap is meaningless if applied an annual limitation. *Id.*

**2. The Commission’s Determination That the Addition of the Word “Annual” to the Language Constitutes A Substantial Change Ignores the Clear Purpose of the Tariff Provision**

The Commission’s determination that the application of an annual cap represents a substantial change to Section 11.2.9.1 fails to take into account the fact that the cap was *always* intended, as explained above, to be an annual cap. Therefore, no change of any kind has occurred. It is true that the word “annual” was added to Section 11.2.9.1 in the Amendment No. 35 proceeding, but, as the ISO explained in that proceeding, the ISO proposed to add the word “annual” not as a substantive change to be applied retroactively, but simply as the correction of an administrative error.<sup>15</sup>

**C. The Proper Course for the Commission Is to Recognize That the Neutrality Cap Has Always Been Applied On Annual Basis And It Does Not Involve Retroactive Rate Making**

The Commission errors in characterizing the addition of the word “annual” to Section 11.2.9.1 as a substantive modification that redefines the neutrality adjustment charge limit “in a manner beyond that claimed by the ISO,” and that therefore should not be applied on a retroactive basis.<sup>16</sup> Because the cap described in Section 11.2.9.1 was always intended to be an annual cap, and indeed *has* always been applied as an annual cap, the Commission would neither be altering the meaning of that section in any respect, nor the impact of the cap on any Market Participant, by merely permitting the ISO to correct the error and leaving untouched the correct neutrality adjustment charges the ISO

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<sup>15</sup> See Transmittal Letter for Amendment No. 35 Filing, Docket No. ER01-836-000 (Dec. 29, 2000), at 11.

<sup>16</sup> March 14 Order at 61,934.

has calculated for Southern Cities at all times since Amendment 27 became effective.

Inasmuch as the omission is of a clerical nature, the legal doctrine applicable here is that of “scrivener’s error.” A scrivener’s error is “a typographical mistake or other error of a clerical nature in the drafting of a document.”<sup>17</sup> It differs from other kinds of drafting mistakes “in that the wording or punctuation of the resulting enactment differs from that which the drafters had meant to enact.”<sup>18</sup> This is exactly what occurred in the instant case. The sole reason that the word “annual” was not originally included in Section 11.2.9.1 was mere administrative error, i.e., a scrivener’s error.<sup>19</sup>

The intent of the ISO Governing Board, the purpose of the neutrality adjustment charge, the ISO’s functions, the ISO’s status as a not-for-profit and revenue-neutral entity, the standard use of MWh as a basic unit, and how the cap

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<sup>17</sup> Michael S. Fried, *A Theory of Scrivener’s Error*, 52 RUTGERS L. REV. 589, 593 (2000). Scrivener’s errors can occur both in documents produced by governmental entities, such as statutes, and in documents produced by private entities, such as contracts between such entities. *See id.*

<sup>18</sup> *Id.* at 594.

<sup>19</sup> This type of error is routinely corrected upon review: “Almost all courts will correct a ‘scrivener’s error.’ John Copeland Nagle, *Corrections Day*, 43 UCLA L REV. 1267, 1288 (1996). For example, the United States Supreme Court held unanimously that the punctuation in a certain act of Congress (termed by the Supreme Court “the 1916 Act”) was wrong due to a scrivener’s error, and should therefore be corrected. *United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 508 U.S. 439 (1993). The Supreme Court explained as follows:

Against the overwhelming evidence from the structure, language, and subject matter of the 1916 Act there stands only the evidence from the Act’s punctuation, too weak to trump the rest. In these unusual cases, we are convinced that the placement of the quotation marks in the 1916 Act was a simple scrivener’s error . . . . The true meaning of the 1916 Act is clear beyond question, and so we repunctuate.

As a result of this determination, the Supreme Court reversed the judgment of the Court of Appeals and ordered that the case be remanded for further proceedings consistent with its opinion. Thus, the Supreme Court required that previous and erroneous understandings of the 1916 Act should be corrected on remand.

has in fact been applied, all indicate that the cap was always intended to be annual, and indeed has been applied on an annual basis. Thus, the mere omission of the word “annual” merits a simple correction and nothing further.

**D. An Hourly Cap Would Be Inconsistent With the Purpose of the Neutrality Adjustment Charge, the ISO’s Functions, and the ISO’s Not-For-Profit Status**

The Commission recognized, both in the March 14 Order and in the contemporaneous Amendment No. 35 Order, that it is improper to require the ISO to absorb costs associated with the neutrality adjustment charge:

- “Regarding the ISO’s contention that there is no basis for requiring it to absorb the costs for maintaining system reliability, we agree.”<sup>20</sup>
- “The ISO is a non-profit entity and there is no basis for requiring the ISO to absorb these neutrality costs on a month-to-month basis when the ISO’s charges are designed to collect its revenue requirement on an annual basis.”<sup>21</sup>

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<sup>20</sup> March 14 Order at 61,934.

<sup>21</sup> Amendment No. 35 Order at 61,928.

In fact, the ISO is prohibited from absorbing neutrality costs and must remain revenue-neutral. Neutrality costs are absorbed by Scheduling Coordinators. The purpose of the neutrality adjustment charge cap is to provide to Scheduling Coordinators as accurate an estimate as possible of their total annual neutrality charges. As detailed below, from a statistical point of view, an annual cap facilitates a more accurate estimate of neutrality charges than would an hourly cap.

**1. Application of An Annual Cap Helps to Shield the ISO From Under-Collection of Neutrality Costs Associated With System Reliability**

Under an annual cap regime, the total neutrality adjustment charges would be calculated for the entire year in question, and then divided by the total number of hours (i.e., megawatt-hours) there are in the year. The result would be the *average* neutrality charge per megawatt-hour. Only to the extent that the average neutrality charge per megawatt-hour exceeded the cap (e.g., a cap at the \$0.095/MWh level) would the ISO be required to receive Board approval for an increase.<sup>22</sup> The result of applying an annual cap is that the ISO minimizes Scheduling Coordinators' exposure to the neutrality adjustment charge, because, for many hours during the year, the ISO will have to make few or no out-of-market purchases. For each of those hours the neutrality adjustment charge will be very low or zero. These many hours of low or zero neutrality adjustment charges will serve to "balance out" the high neutrality adjustment charges over a

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<sup>22</sup> This explains why an annual cap regime employs what the Commission calls the "per megawatt-hour" unit, see March 14 Order at 61,934, described in Section 11.2.9.1: the average neutrality charge per megawatt-hour is compared to that unit for the purposes of determining whether the cap has been exceeded.

relatively few number of hours per year, once all of the charges are averaged together. Thus, the annual neutrality adjustment charge estimate will be more accurate than one based on a shorter period of time, such as one on a monthly or hourly basis.

**2. Application of An Hourly Cap Does Not Provide the ISO With A Mechanism to Fully Collect Neutrality Costs During Some and Possibly Much of the Year**

On the other hand, if the cap is applied on an hourly basis, the only way that the ISO can ensure revenue-neutrality is if, *for each hour of the year*, the neutrality charge does not exceed the cap. If the cap were to be exceeded for even one hour of the year, the ISO would not even know the cap was exceeded until settlement was conducted, 45 days later. Any hours wherein the cap was exceeded would result in ISO violation of its Tariff which prohibits the ISO from exceeding the \$/MWh cap. The ISO used a neutrality projection of \$0.095/MWh multiplied by the year 1999 total MWh of 2,375,000 to reach an approximate annual cost of \$25 million. Consistent with the ISO Tariff, once neutrality costs were within ten percent (10%) of that annual estimate, i.e., approximately \$23 million, in year 2000, ISO management requested that the ISO Governing Board increase the rate. As noted in the attached memorandum, the ISO's increase in the annual cap was necessitated based on accumulated neutrality costs for the period January 2000 through June 2000. The memorandum notes that this cap was intended to be annual.<sup>23</sup> In essence, the Board approved an increase of the annual cap through the remainder of the applicable year, i.e., from September



15, 2000 through January 15, 2001. The rate increase was granted, and the limit of total charges levied under Tariff Section 11.2.9 was increased from \$0.095/MWh to \$0.35/MWh for the period of September 15, 2000 through January 15, 2001. This change, consistent with the Tariff, ensures that the ISO charges enough to pay the neutrality costs and thus remains revenue-neutral in the total transaction.

To summarize, an annual cap is virtually certain to result in neutrality costs that are smaller than the costs under an hourly cap, and in any case it is impossible for the costs under the annual cap to be larger than the costs under the hourly cap. For this reason, the Commission is incorrect in stating that “[t]he resulting neutrality charge capped on an annual basis is effectively the same as the previously filed rate without the annual limitation.”<sup>24</sup> As explained below, the two can be – and in fact are – very different from one another.

**E. Requiring the ISO to Implement An Hourly Cap Would Wreak Havoc and Create Significant Financial Harm to the ISO In Contravention of the Commission’s Intent In Approving Section 11.2.9.1**

The ISO’s concern that an annual cap be implemented is not merely academic. The imposition of an hourly cap would cause great damage to the operations and finances of the ISO. The Commission certainly did not intend such results.

First, the practical effect of the Commission's order is to cause other Scheduling Coordinators to be billed for neutrality costs that would no longer be

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<sup>23</sup> See attached memorandum, dated August 29, 2000, at 2 (“The language in Amendment 27 omitted any reference to time frame, but the intent was to set this threshold on an annual basis.”).

paid by Southern Cities. The ISO would be forced to bill other Scheduling Coordinators through the neutrality charge to ensure collection of the ISO's neutrality costs. Applying the Commission's hourly cap rationale to these other Scheduling Coordinators would in turn force the ISO to either absorb these costs itself or short the market.

Second, the use of the hourly cap method would result in the ISO's Settlement process becoming hopelessly complicated and impracticable. The ISO would have to calculate by what amount, if any, the cap was being exceeded for each individual hour. Such hourly calculations would put an unmanageable burden on the ISO's computer system. By contrast, the annual cap method would be applied on a much less frequent basis, and thus would be relatively simple to calculate.

**F. An Annual Cap Is Based On A Statistically Reliable Period**

**1. The Change In the Cap From \$0.095/MWh to \$0.35/MWh Was Conducted Properly Under The Tariff**

The Commission is incorrect in stating that "the ISO is attempting to apply an annual neutrality cap to a limited three and a half month period."<sup>25</sup> As permitted under Section 11.2.9.1, the ISO Governing Board temporarily increased the annual \$0.095/MWh cap to \$0.35/MWh. This change in the annual cap was made pursuant to the Tariff and the ISO's intent to adjust the cap should the total accrued neutrality adjustment charge for any year approach ninety percent (90%) of the total annual cap. The change was instituted to ensure that the ISO collected enough through the neutrality adjustment charge to defray

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<sup>24</sup> See Amendment No. 35 Order at 61,928.

costs incurred by the ISO. Once this cap expired on January 15, 2001, the \$0.095/MWh automatically went back into effect. Thus at no time was there any change in the basis of the cap, i.e., it remained, as always, on an annual basis.

**2. A Neutrality Adjustment Charge Cap Based Upon An Estimate Derived From A Larger Sample Size Is Superior to One Based On A Smaller Sample Size**

Critically, a neutrality adjustment charge cost cap based on a year's worth of information is certain to be more accurate than an estimate based upon a shorter period of time. This is because the larger the sample size, the better the estimate. By using a year as the sample size, a large number of hours with zero neutrality charges will be included. The zero charge hours will buffer the estimate from undue statistical skewing by the relatively fewer hours with high neutrality charges. Inasmuch as the goal is to produce an estimate that is as accurate as possible, the larger sample size should be used. When this reason is coupled with the goal of Scheduling Coordinators using the cap for their annual budget planning, as well as all of the other reasons set forth above, it becomes clear why the ISO, from the beginning, has set the neutrality adjustment charge cap on an annual basis.

In addition, there is no need for concern that the temporary change in the annual price cap, from \$0.095/MWh to \$0.35/MWh for the period of September 15, 2000 through January 15, 2001, will prevent the ISO from accurately gauging the effectiveness of the \$0.095/MWh cap. Statistically, a sample size of eight months remains vastly superior to one based upon hours. Further, while not likely to be necessary, the ISO can elect to extend the \$0.095/MWh cap for an

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<sup>25</sup> See March 14 Order at 61,934.

additional four months to ensure a full year's worth of data for the evaluation of the cap. The most important thing is that the cap is on an annual basis and that the ISO has sufficient data to assess the cap's accuracy and to identify the need to make adjustments that respond to the longer term trends, i.e., over one year, as opposed to the wildly variable changes that occur in neutrality costs on an hour-by-hour-basis.

## V. CONCLUSION

WHEREFORE, for the above-stated reasons, the ISO respectfully requests that the Commission grant rehearing of its March 14, 2001 Order Dismissing in Part and Granting in Part Complaint, and that the Commission further find, determine, and order:

- (1) That the neutrality adjustment charge cap under Section 11.2.9.1 of the ISO Tariff is properly applied on an annual rather than an hourly basis.
- (2) That the annual cap described above is to be applied from the time that Section 11.2.9.1 first went into effect.

Respectfully submitted,

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