UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Duke Energy Moss Landing LLC	**)**	**Docket No. ER99-1127**
	)	
Duke Energy Oakland LLC	**)**	**Docket No. ER99- 1128**
		(not consolidated)

MOTION TO INTERVENE, PROTEST,
REQUEST FOR HEARING,
AND MOTION TO CONSOLIDATE OF
THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

To the Commission:

Pursuant to Rules 211, 212 and 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211, 385.212 and 385.214, the California Independent System Operator Corporation (ISO), hereby moves to intervene in and protests the above-captioned filing. It is possible that Duke Energy Moss Landing, LLC and Duke Energy Oakland, LLC can use the filed agreements to circumvent their obligation to credit back to the ISO a portion of the margins realized on market sales from their Must-Run Units. As such, the ISO requests that it be given leave to intervene in this proceeding and that the Commission set the agreements for hearing. In addition, because the instant filings involve issues that are integrally related to matters already pending in the Must-Run terms and conditions proceedings (Docket Nos. ER98-441-001, ER98-495-001, ER98-496-001, ER98-4300-001, ER98-2668-004, ER98-2669-003, and ER984296-001) the ISO respectfully requests that the instant filings be consolidated with those on-going, consolidated proceedings. In the alternative, the ISO requests that the two instant filings be consolidated into one proceeding, as they raise essentially identical issues.

I. INTRODUCTION

Following its successful bid for the purchase of PG&E's Oakland and Moss Landing Power Plants, both of which contain Must-Run units, Duke Energy filed for FERC approval of its Must-Run service contracts. In an Order issued June 25, 1998, the Commission accepted the proposed service agreements for filing, including the provision to credit back to the ISO 90% of the revenues from market sales. *Duke Energy Moss Landing*, 83 FERC ¶ 61,318 (1998). The Commission also explicitly held that the ISO was not to be held responsible for recovery of Duke Energy's acquisition adjustment. *Id.* at 62,305. Instead, recovery of any such premium was to be had from Duke Energy's market-based sales, and the acquisition premium was not to be used in determining the cost-based Must-Run rates. *Id.*

In separate filings, Duke Energy Moss Landing and Duke Energy Oakland also requested blanket authority to sell power at market-based rates when Must-Run service was not required. The Commission granted such blanket authority to the two entities (as well as to a third Duke Energy subsidiary, Duke Energy Morro Bay) and required each owner to file an umbrella agreement for such market-based sales within 30 days of the commencement of any short-term service. *Duke Energy Moss Landing,* 83 FERC ¶61,317, at 62,295 (1998). In the instant filings, Duke Energy Moss Landing and Duke Energy Oakland now seek to make such short-term sales to two of their trading affiliates, Duke Energy Trading and Marketing LLC and Duke\Louis Dreyfus LLC.

While the ISO has no objection to the Must-Run owners' use of their affiliated trading entities to maximize the revenues they can generate from sales into the market, any such arrangement must be designed to preserve the ISO's (and California consumers') contractual right to receive a full 90% credit back for sales made into the market from the two Must-Run facilities -

- regardless of which Duke Energy affiliate makes the sale. Under the proposed umbrella agreements, the two Must-Run owners will be permitted to sell capacity and energy to their marketing affiliates at an unregulated price. However, as the Commission is well aware, a sale to an affiliate is by definition not an arm's-length transaction. As such, it may not reflect the true market price. In turn, Duke Energy's two marketing entities will resell that energy into the PX or elsewhere at the true market price. Unless adequate safeguards are put in place in this proceeding, the Duke Energy Must-Run owners will be able to avoid their obligation to credit back to the ISO the full 90% of the margins realized from an arm's length market transaction, while the Duke Energy family retains those revenues.

II. SERVICE

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III. DESCRIPTION OF THE PARTY

The ISO is a non-profit public benefit corporation organized and existing under the laws of the State of California, in which it is authorized to do business. On March 31, 1998, the ISO took control of and currently operates the transmission systems of Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (SDG&E) and Southern California Edison Company (SCE). The ISO is responsible for maintaining the reliability of electric transmission scheduled into, out of and through the ISO Control Area. The activities of the ISO are subject to the jurisdiction of the Commission.

IV. MOTION TO INTERVENE

On December 31, 1998, Duke Energy Moss Landing and Duke Energy Oakland filed two unexecuted, umbrella service agreements providing for the short-term sale of capacity and energy to two of their trading affiliates, Duke Energy Trading and Marketing, LLC, and Duke/Louis Dreyfus LLC. The Commission issued a notice of filing on January 8, 1999, setting January 20, 1999, as the deadline for intervention or protest.

While the Commission has granted Duke Energy Moss Landing and Duke Energy Oakland blanket authority to sell capacity and energy at market-based rates, it has not considered the potential for affiliate abuse raised by the instant filings. As the purchaser of Duke Energy's Must-Run services, and the intended recipient of any credits due from Duke Energy's market sales from the units, the ISO has a direct and substantial interest in this proceeding. Moreover, the ISO's interests cannot be adequately represented by any other party. Accordingly, the ISO respectfully requests that it be permitted to intervene herein with full rights of a party.

V. PROTEST AND REQUEST FOR HEARING

Both the Moss Landing and Oakland units currently sell Must-Run services to the ISO under Must-Run Schedule B. Schedule B provides for *full recovery of Duke's fixed costs for the units through payments by the ISO*, regardless of whether and how often the ISO actually calls on the units. Thus, the Schedule B Contracts are designed to ensure that Must-Run services will be available as needed, by covering the full fixed costs of the Must-Run Units. However, Schedule B was also designed to protect California customers from the high costs of such guaranteed recovery, by requiring Must-Run owners to credit back to the ISO (and ultimately to California electric consumers) the majority of the margins received for market-based sales.

It is vital that this mechanism for protecting California consumers be preserved. Accordingly, the instant agreements should be approved only on the condition that subsequent sales made by the trading affiliate will be considered as part of the sales margin earned by the Must-Run owner, 90% of which must be credited back to the ISO. In that way, the Duke Energy Must-Run owners can use their affiliated trading arms to identify optimal market opportunities, without circumventing the intended Must-Run contractual obligations and consumer protections.

It is important to recall that the order authorizing the Duke Energy Must-Run owners to charge market-based rates did not address this particular affiliate issue, *i.e.*, the potential for abuse where *the purchasing or selling affiliate has captive customers*. In that order, the Commission only addressed the possibility of affiliate abuse due to sales *to* a franchised utility, and never addressed the impact that a below-market sale to an affiliate would have on Duke Energy's captive customers for Must-Run service (*i.e.* the ISO and ultimately all California ratepayers). *See* 83 FERC ¶61,317 at 62,294. The reason, perhaps, is that the Duke Energy Must-Run owners did not hold themselves out as traditional public utilities. Rather, they held themselves out as stand-alone generators making competitive sales. They asserted, mistakenly, that they had addressed all affiliate abuse problems because they would not be selling power to any affiliate that had captive customers absent a separate section 205 filing, and had filed a code of conduct. *See id.*

In *Detroit Edison Co.*, 80 FERC ¶ 61,348 (1997), the Commission explained the need to protect captive customers from the effect of below-market sales by a franchised utility to an affiliate:

> The Commission is concerned that Detroit Edison may have an incentive to favor sales of power to its affiliate, . . . to the detriment of [its] captive customers. Affiliate abuse take place when the public utility and its affiliated power marketer transact in ways that result in a transfer of benefits from the affiliated public utility (and its captive customers) to the affiliated power marketer (and its shareholders).[] ***For example, if Detroit Edison sells power to [its affiliate] under its proposed cost-based power sales tariff, whether at a discounted cost-based rate or even at the cost-based ceiling rate, and if the market price at the time the sale is agreed to is higher than the cost-based rate, then Detroit Edison's captive customers will be harmed. In effect the difference between the market price and the cost-based rate would be transferred from Detroit Edison's captive customers to [its affiliate's] shareholders (which are the same shareholders as Detroit Edison's shareholders)*.[]**

Detroit Edison, 80 FERC at 62,197 (footnotes omitted) (emphasis added).

In providing Must-Run service to the ISO, the Duke Energy Must-Run owners are analogous to a franchised utility in that they also have captive customers, *i.e.*, the ISO and ultimately all California ratepayers who pay the cost of Must-Run service.[1] By definition, Must-Run services are necessary for the provision of reliable electric service, and the ISO has no other alternative but to purchase such services from each Must-Run owner as needed. Under the

[1] The ISO Tariff (section 5.2.7) requires the transmission owning utility in whose service area the Must-Run unit is located to pay the cost of Must-Run service. This utility then passes these costs on to its ratepayers. In the case of the Duke Energy Must-Run owners, the utility responsible for these costs is Pacific Gas and Electric Company.

proposed agreements, the Duke Energy Must-Run owners can sell power to their affiliates at below-market rates, who then resell the same power at substantially higher rates -- the very problem noted in *Detroit Edison*. Despite the affiliates' receipt of a true market price, the Duke Energy Must-Run owners could credit back to the ISO only the revenues received from their initial, below-market sale to their affiliate.[2]

There is strong reason to believe that Duke Energy intends to negate its contractual obligations to credit market revenues by using its trading affiliates for sales into the market.[3] To date, Duke Energy has made only a tiny credit to the ISO for its market-based sales, despite having scheduled with the ISO significant amounts of non-Must-Run energy from Moss Landing and Oakland. The ISO has two distinct concerns regarding Duke Energy's lack of market revenue credits: (1) affiliate abuse, and (2) the failure to credit a full 90% of sales margins based on Duke energy's unique Must-Run contracts. First is the potential for affiliate abuse in the sale of capacity and energy in market transactions. Since the ISO pays the full fixed cost of service for Must-Run facilities under the Condition B agreement, it is very interested in the amount of market revenues a Must-Run owner receives when it is conducting market transactions. The ISO estimates that from April to December 1998 Duke Energy would have received $119,315,210 in market

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2 Not only is there harm to captive customers from the proposed agreements, but there is also additional harm to the functioning of the competitive market itself. Under Must Run Condition B, Duke Energy Must-Run owners will recover their full fixed costs from the ISO, which arguably has given Duke Energy and similarly situated Must-Run owners an unfair competitive advantage. Now, with the potential for the Duke Energy family to receive not only the full fixed cost of service through the Must-Run payments, while retaining the profits from its market-based sales through the trading affiliates, the competitive market stands to become even more skewed. Thus, the instant agreements only serve to exacerbate the competitive concerns already raised by the Must-Run structures.

3 On August 3, 1998 Duke/Louis Dreyfus LLC filed a notification with the Commission stating that it had become affiliated with four new companies: Duke Energy Moss Landing, LLC, Duke Energy Oakland, LLC, Duke Energy Morro Bay, LLC and Bridgeport Energy, LLC.

revenues for energy and $6,073,390 in market revenues for ancillary services.[4] The ISO estimates that Duke Energy's costs for fuel would have been $76,681,443, leaving $48,707,157 in sales margin, of which the ISO should receive 90%, or $43,836,442. This estimate is based on the amount of energy and capacity scheduled by Duke Energy for non-Must-Run transactions, the PX market clearing price, the ISO's Day-Ahead Ancillary Services market clearing prices and PG&E's actual monthly average cost for fuel, including transportation to the facility, during the April through December period. The ISO acknowledges that this is an estimate, but has included this estimate to emphasize that Duke Energy is or should be receiving substantial market revenues.

As described above, Schedule B envisions a system whereby the ISO will fully cover Duke's fixed costs, but will receive a credit back for 90% of Duke Energy's margin from market-based sales.[5] Thus, to the extent that Duke Energy is making profitable sales at market-based rates rather than limiting itself to Must-Run services, it is required to credit back a portion of its excess earnings, thereby repaying the ISO for a portion of Duke Energy's fixed costs. Duke Energy needs to explain why almost no credits to date have been offered and why the sales to its affiliates have not and will not defeat negate the credit mechanism, *i.e.* how -- if it does -- the crediting mechanism reflects a fair market price rather than the non-arm's length price negotiated between Duke Energy Moss Landing, Duke Energy Oakland, and its affiliates. The ISO fears that merely accepting these umbrella agreements without examining these crucial issues will be construed by Duke as eliminating or at a minimum diminishing its obligations to credit revenues.

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4 The ISO has not calculated how much Duke Energy has sold in the PX Hour-Ahead market, the ISO Hour-Ahead Ancillary Services markets, nor the ISO imbalance energy market, but it can be assumed that this number would increase the amount of sales margins which should be credited to the ISO.

5 Allowing Duke to retain 10% of its margin gives Duke an incentive to make such sales.

Given the clear opportunity for affiliate abuse to the detriment of captive California customers, the Commission must take particular care to prevent Duke Energy from passing market opportunities (and earnings) on to its trading affiliates. Instead, the Commission should set the agreements for hearing, to consider appropriate safeguards and conditions to be imposed on Duke Energy's use of a trading affiliate to market power and energy from its Must-Run Units. In addition, the Commission should consider whether Duke Energy Moss Landing and Duke Energy Oakland have been providing adequate credits to the ISO from sales currently made on their own behalf, or through an affiliate, into the market.

The ISO's second concern is that Duke Energy's unique contract provides that all market revenues are applied first towards Duke Energy's recovery of the companies' acquisition adjustments before any revenues are applied to the fixed costs under the Must-Run agreement. Section 6.4(b) of the Duke Energy Must-Run contracts state:

> If a Unit is subject to Condition of Must-Run Agreement B, the Availability Payment shall be reduced by the Availability Payment Credit in accordance with this Section 6.4(b). The Availability Payment Credit shall be equal to 90 percent of the Sales Margin, as defined in Section 6.4(c) below, after deducting the portion of Owner's Acquisition Adjustment Revenue Requirement, as defined in Section 6.4(d) below, disallowed or otherwise excluded from recovery through rates under this Agreement.

Duke Energy's contract is additionally unique in that it allows the Must-Run Owner to use actual market revenues for energy, as opposed to using a proxy price based on the California Power Exchange Corporation's ("PX") market clearing price. All other Must-Run Condition "B" agreements require a Must-Run owner to credit back all market revenues towards its fixed costs based on the PX proxy price.

While Duke Energy was ordered by the Commission to exclude the acquisition adjustment from the Must-Run reliability payment and availability payment directly,[6] the ISO is not recovering the credits it believes to be due. The ISO has been unable to pinpoint whether the lack of crediting back of sales margins is due to the deduction of the acquisition adjustment from market revenues or the fact that the market revenues are from affiliate transactions. Either way, the ISO's concerns need to be addressed by the Commission.

VI. MOTION TO CONSOLIDATE

The Commission is in the process of reviewing the terms and conditions of all the California Must-Run contracts as part of Docket Nos. ER98-441-001, ER98-495-001, ER98-496-001, ER98-4300-001, ER98-2668-004, ER98-2669-003, and ER984296-001. Among other things, the Commission will consider the overall structure of those contracts, including whether the fixed payment and crediting provisions adequately take into account the need for Must-Run services without providing unfair subsidies to Must-Run owners. In the instant filings, Duke Energy is seeking to establish a unique structure which may allow the Duke Energy Must-Run owners to circumvent the contract structures intended to apply to all Must-Run owners. Given the substantial overlapping issues in these proceedings, the ISO requests that the two instant filings be consolidated with the on-going RMR terms and conditions proceedings. At a minimum, however, the two instant filings should be consolidated into one proceeding, as they raise virtually identical issues involving identical parties.

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[6] 83 FERC ¶ 61,318 (1998).

VII. CONCLUSION

Wherefore, based on the foregoing, the ISO respectfully requests that the Commission set the proposed agreements for hearing to consider how to ensure that sales to the Duke Energy trading affiliates are not used to circumvent the Must-Run owners' obligation to credit back to the ISO and to California consumers the full 90% of sales margins earned. In addition, the ISO requests that it be granted leave to intervene in these proceedings, and that the instant filings be consolidated as described above.

Respectfully submitted,

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