

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

Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California)	
)	
v.)	Docket No. EL00-111-000
)	
California Independent System Operator Corporation)	

**ANSWER OF
THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR
CORPORATION TO COMPLAINT OF THE CITIES OF ANAHEIM,
AZUSA, BANNING, COLTON, AND RIVERSIDE,
CALIFORNIA**

Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2000), and the Commission’s September 18, 2000, Notice of Filing, the California Independent System Operator Corporation (“ISO”)¹ hereby submits its Answer to the Complaint of the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (collectively, “Southern Cities”) filed in the above-captioned proceeding.

I. Summary

On September 15, 2000, the Southern Cities filed a complaint against the ISO alleging: (1) that the ISO’s collection from all Scheduling Coordinators (“SCs”) of costs incurred in procuring Energy through real-time “out-of-market” (“OOM”) dispatch

¹ Capitalized terms not otherwise defined herein shall have the meaning as defined in the Master Definitions Supplement, Appendix A to the ISO Tariff.

instructions, when bids for the supply of Imbalance Energy are insufficient, is unjust and unreasonable, and (2) that the ISO has violated Section 11.2.9.1 of the ISO Tariff by imposing neutrality adjustment charges in excess of the limit established in that section without completing proper procedures. Complaint at 9, 12. As relief, they ask FERC to require: (1) a change in the provision of the ISO Tariff that governs the recovery of costs of OOM dispatch instructions incurred by the ISO to meet system reliability requirements, and (2) that the ISO abide by the cap on neutrality adjustment charges in Section 11.2.9.1 of the ISO Tariff, which became effective on June 1, 2000, and to refund neutrality adjustment charges in excess of that cap collected for trading intervals subsequent to that date. Complaint at 1.

For the reasons discussed below, the ISO urges the Commission to find that the Complaint is unfounded.

A. The Complaint's challenge to Section 11.2.4.2.1 of the ISO Tariff, through which the costs of OOM purchases to maintain overall system reliability are allocated to SCs, disregards the fact that the Commission accepted this allocation of costs in its January 7, 2000, Order on Amendment No. 23 to the ISO Tariff, when it approved a different cost allocation approach for costs associated with other OOM purchases. *California Independent System Operator Corp.*, 90 FERC ¶ 61,006, at 61,015, *reh'g denied*, 91 FERC ¶ 61,026 (2000). The Commission also accepted a similar approach in Amendment No. 28, when it approved the allocation of costs associated with the ISO's Summer 2000 Demand Relief Program to all SCs in proportion to their metered demands. *California Independent System Operator Corp.*, 91 FERC ¶ 61,256, at 61,897 (2000). As the Commission noted there, "maintenance of grid reliability benefits

all loads that rely on the ISO Controlled Grid.” *Id.* (emphasis in original). The Complaint’s contention that the same cost allocation method approved by the Commission is unjust and unreasonable when applied to costs of OOM purchases to maintain system reliability is therefore unfounded. The ISO notes, however, that it is exploring alternative approaches to the allocation of these costs. In particular, the ISO is considering an approach that would allocate these costs to SCs whose failure to include their Loads in forward Schedules contributes to the ISO’s need to procure Energy through OOM purchases. This approach is being considered in connection with the ISO’s comprehensive review of its Congestion Management process and related issues, and as a result of ISO Governing Board direction contained in the September 7, 2000, motion involving the ISO’s cap on neutrality charges. However, the potential for revision to this cost allocation approach does not support the Southern Cities’ claim that the current approach, which has twice been accepted by the Commission, is unjust and unreasonable.

B. Southern Cities’ second claim is also unfounded insofar as they allege that the ISO should be denied recovery of costs recovered through the neutrality adjustment charge to the extent such charges exceed the levels established pursuant to Section 11.2.9.1 of the ISO Tariff. First, the purpose of the neutrality adjustment charge is to ensure that, as a not-for-profit entity that operates Ancillary Service and real-time Energy markets for the benefit of SCs that rely on the ISO Controlled Grid, the ISO would remain in a cash-neutral condition. The events of this summer, in which the ISO has been called upon to meet unprecedented demands for real-time Energy, have led to increased OOM purchases to maintain system reliability and, consequently, increased

neutrality adjustment charges to recover the costs of those purchases. There is no basis, however, for requiring the ISO to absorb the costs it has incurred to maintain system reliability and such a requirement would be contrary to the purpose both of the neutrality adjustment charge and the ceiling that was added to Section 11.2.9.1 by Amendment No. 27. Second, the limitation on neutrality adjustment charges was intended to project, on an annual basis, neutrality expenses. It was not intended, as alleged by Southern Cities, to be an hourly limit or to prohibit recovery of legitimate costs incurred. There is no basis for the Southern Cities' demand that the ISO be denied recovery of any of these costs.

II. The Justness and Reasonableness of the ISO Tariff Method for Allocating Costs of OOM Purchases for System Reliability Has Been Confirmed by the Commission.

Southern Cities' Complaint first challenges Section 11.2.4.2.1 of the ISO Tariff, which sets forth both the manner in which the ISO compensates Market Participants from which the ISO purchases Energy out-of-market and the manner in which the resulting costs are allocated to SCs. As the Commission described in its January 7, 2000, Order on Amendment No. 23 to the ISO Tariff:

. . . [P]ayment [for OOM purchases or "calls"] will be allocated according to the reason for the dispatch order. The costs of a resource dispatched pursuant to an OOM call to address transmission outages or a location-specific requirement will be allocated to the transmission system where the transmission facility is located or the location specific requirement arose. If the OOM dispatch order is the result of market shortages or any other system-wide requirement, the costs will be flowed through to all loads, consistent with the existing procedure.

California Independent System Operator Corp., 90 FERC at 61,015. Southern Cities argue that it is unjust and unreasonable to collect the costs of OOM purchases made to

address “market shortages” from all SCs, including those that do not cause the ISO to incur such costs. As relief, they ask that the Commission direct the ISO to replace the last two sentences of ISO Tariff Section 11.2.4.2.1 with the following language:

To the maximum extent possible, the ISO shall allocate to Scheduling Coordinators, in proportion to their deviations from scheduled Loads, the costs that the ISO incurs to procure power to serve their unscheduled Loads.

Complaint at 12.

There is no basis for Southern Cities’ contention that the current method of allocating costs of ISO purchases of Energy to maintain system reliability in light of insufficient market bids is unjust and unreasonable. Indeed, this contention flies in the face of Commission precedent. As noted, the Commission accepted the existing approach to the allocation of OOM purchases in its January 7, 2000, Order on Amendment No. 23. Moreover, the Commission dealt with a virtually identical argument in connection with Amendment No. 28 to the ISO Tariff. There, the issue concerned the allocation of costs incurred by the ISO in connection with its Summer 2000 Demand Relief Program. The ISO proposed to recover these costs from all SCs in proportion to their metered demands during the period that the ISO made purchases under this program. Certain intervenors challenged this aspect of the proposal, arguing that the costs of these purchases should be recovered only from those SCs whose failure to arrange for sufficient reserves created the need for the Demand Relief Program. The Commission rejected these claims, stating, “[W]e agree with the ISO that maintenance of grid reliability benefits *all* loads that rely on the ISO Controlled Grid and, therefore, that allocation of program costs on a system-wide basis (i.e., to all Scheduling

Coordinators) is reasonable.” *California Independent System Operator Corp.*, 91 FERC at 61,897 (emphasis in original).

The same reasoning applies in the case of the costs of OOM purchases made to address market shortages. The ISO issues OOM calls in these circumstances to preserve system reliability, which benefits all SCs that rely on the ISO Controlled Grid. It is accordingly reasonable for the costs associated with these purchases to be recovered from all SCs in proportion to their metered Demands, as Section 11.2.4.2.1 accomplishes through the inclusion of these costs in the neutrality adjustment charges.

While Southern Cities’ challenge to the reasonableness of the existing cost allocation methodology is therefore unfounded, the ISO recognizes that there is more than one reasonable method of allocating these costs. The ISO is exploring with stakeholders the desirability of modifying the existing approach to the allocation of OOM purchases for system reliability to enhance the incentives for Scheduling Coordinators to follow sound scheduling practices, including making the necessary arrangements in forward markets to meet all of their anticipated Demands. This issue is being considered in connection with the ISO’s comprehensive review of its Congestion Management process and related issues, and as a result of the September 7, 2000, motion passed by the ISO Governing Board on the cap on neutrality charges. For example, the ISO Governing Board motion states, in part, that ISO Management is to pursue certain actions and implement them as appropriate. One of those actions is to allocate to SCs, in proportion to their deviations from schedules, the costs that the ISO incurs to serve those deviations. As a result, the ISO may soon be presenting a modification to Section 11.2.4.2.1’s cost allocation methodology that is responsive to the

concerns expressed by Southern Cities. This possibility, however, does not alter the fact that Southern Cities have failed to carry their burden under Section 206 of the Federal Power Act, 16 U.S.C. § 824(e) (2000), to demonstrate that the existing cost allocation methodology, which was explicitly approved by the Commission in closely analogous circumstances, is unjust and unreasonable. The Complaint fails to present any basis for premitting the consideration of this issue through the stakeholder process.

III. The Neutrality Adjustment Charge Cap Projects Neutrality Charges Over the Course of a Year and Provides an Explicit Means Through Which Neutrality Charges Will Be Monitored by the ISO Governing Board; It Does Not Constrain Cost Recovery by the ISO.

As part of Amendment No. 27 to the ISO Tariff, which proposed a new method for the determination of transmission Access Charges, the ISO proposed to add Section 11.2.9.1 to the ISO Tariff, to place *annual* limits on the level of the neutrality adjustment charges assessed pursuant to Section 11.2.9 of the ISO Tariff. Those charges are assessed on SCs, in proportion to their metered Demands during a Trading Day or other appropriate interval, to enable the ISO to reach an accounting balance of zero, because, among other reasons, the amounts it receives from SCs during the Trading Day would otherwise exceed the amounts it pays out to SCs. Proposed Section 11.2.9.1 places a \$00.095/MWh cap on neutrality adjustment charges, subject to adjustment of the cap by the ISO Governing Board.² The Commission accepted

² Section 11.2.9.1 of the Tariff reads:

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

Amendment No. 27, including Section 11.2.9.1, effective June 1, 2000, suspended it, and set it for hearing, although it is holding the hearing in abeyance pending efforts at settlement. *California Independent System Operator Corporation*, 91 FERC ¶ 61,205 (2000).

Southern Cities allege that “[t]he ISO has violated its Tariff on a number of occasions since June 1, 2000, by imposing Neutrality Adjustment Charges in excess of the limits provided for in the Tariff.” Complaint at 12. As relief, they ask the Commission to require the ISO to “abide by the terms of §11.2.9.1 of the ISO Tariff and to refund all Neutrality Adjustment Charges in excess of the limitation in §11.2.9.1 collected during the period that the \$0.095/MWh limit was in effect.” Complaint at 14. Southern Cities would thus treat the limit on neutrality adjustment charges established by Section 11.2.9.1 as an absolute limit on the ISO’s recovery of costs from SCs, to be applied separately in each hour.

Southern Cities’ interpretation of Section 11.2.9.1 is contrary to the language and intent both of that provision and of Section 11.2.9 generally. The cap on the level of neutrality adjustments is not a limit on the ISO’s recovery of market and other costs, which would violate the cost recovery mechanisms provided for in the California electric industry restructuring legislation. See Cal. Pub. Util. Code §365(a) (West 2000); see also, *Pacific Gas and Electric Company, et al.*, 81 FERC ¶ 61,122, at 61,459 (1997) (“*Pacific Gas and Electric Co.*”).

As a not-for-profit, public benefit corporation, the ISO designs its rates and charges for the purpose of recovering its costs, and no more. See *Pacific Gas and*

ISO provides at least seven days’ advance notice to Scheduling Coordinators of the determination of the ISO Governing Board.

Electric Co., 81 FERC at 61,446. It is a revenue neutral entity, authorized under California state code and Commission precedent to recover its costs from the Market Participants on whose behalf it operates the Ancillary Service and Imbalance Energy markets and, where necessary, makes OOM purchases to maintain system reliability. See Cal. Pub. Util. Code § 365(a); *Pacific Gas and Electric Co.*, 81 FERC at 61,459. In keeping with that mandate, the neutrality adjustment charge was included in the ISO Tariff to ensure the ability of the ISO to recover particular costs which may not otherwise be recoverable through other provisions in the Tariff.

In particular, neutrality adjustments recoverable under Section 11.2.9 include the costs incurred by the ISO when it purchases Energy because SCs' bids in the Imbalance Energy market are insufficient to maintain the reliability of the ISO Controlled Grid.³ As noted above, the Commission has specifically endorsed the appropriateness of the ISO's recovery of these costs from SCs.

The neutrality adjustment charge cap established by Section 11.2.9.1 was included in Amendment No. 27 in order to project neutrality charges over the course of a year and thereby enhance the ability of Market Participants to budget for the costs of participation in the ISO. Interpreting the cap on neutrality adjustment charges as a prohibition on the ISO's recovery of legitimate costs would allow this subsection of Section 11.2.9 to subvert the purpose of the whole section. It would convert a mechanism for ensuring the ISO's revenue neutrality to one that has the potential to undermine the ISO's financial viability. Plainly, this result was never intended.

³ The costs incurred in such purchases are one reason why the ISO's payments due to SCs during a Trading Day may be less than the charges otherwise recoverable from SCs during the Trading Day, as provided in Section 11.2.9(c).

As noted above, the limit on neutrality adjustments is a means to project, on an annual basis, neutrality expenses. It provides Market Participants with a measure of the projected costs and it provides an explicit means through which ISO Management and the ISO Governing Board will monitor the amounts being billed through neutrality. This can be the only reasonable interpretation of the provision and is the only construction that gives effect to the revenue neutrality requirement. The ISO is authorized to recover costs through a market mechanism. See Cal. Pub. Util. Code § 365. Moreover, the language of Section 11.2.9 specifically limits the neutrality adjustment charge to particular intervals. See §11.2.9(a), (e) (“These charges will be allocated amongst Scheduling Coordinators over an interval determined by the ISO.”). It would not make sense for the ISO to have completely prohibited the recovery of such costs incurred.

A situation has prevailed this summer when extreme weather conditions throughout the West and other factors have led to a sudden increase in the amount of Energy that the ISO has had to acquire through OOM purchases, as well as the increases in prices that the ISO has had to pay. This in turn has led to an increase in costs recoverable through neutrality adjustment charges during some hours, although in other hours the charges have remained below the ceiling levels. Meanwhile, the ISO is considering ways to address the factors that contribute to increased neutrality adjustment charges in the stakeholder process established to review Congestion Management and the ISO Governing Board has approved a temporary increase in the

ceiling on those charges, so that amounts deferred for future recovery can be minimized.⁴

The observation in the Complaint that neutrality adjustment charges have exceeded the level of the cap “on an hourly basis” does not establish that the cap has been violated. Complaint at 14. To the contrary, the Amendment No. 27 modification as endorsed by the ISO Governing Board was that neutrality charges would not exceed \$0.095/MWh on an *annual* basis, absent further action by the ISO Board.⁵ The limitation was never intended as an hourly cap and Southern Cities' attempt to use it in this manner is improper.

There is, moreover, no basis for Southern Cities' demand that the ISO be denied recovery of costs recoverable under the neutrality adjustment charge to the extent the charge exceeds the cap during any hourly period. Complaint at 14. As a not-for-profit public benefit entity, the ISO cannot simply absorb the cost at issue and it plainly did not propose a cap on neutrality adjustment charges that would require it to do so. The limitation on neutrality adjustment charges for particular intervals does not diminish the appropriateness of the ISO's recovery of these costs from the SCs that benefit from the

⁴ On September 7, 2000, the ISO's Board of Governors approved an increase to the limit of total charges levied under Section 11.2.9 of the ISO Tariff from \$0.095/MWh to \$0.35/MWh for the period of September 15, 2000 through January 15, 2001.

⁵ The proposed tariff language included as Attachment A to the March 9, 2000, Governing Board memorandum that served as the basis for the Governing Board's Approval of Amendment No. 27 explicitly described the cap as an annual cap. See Appendix I, which contains an excerpt from the March 9, 2000, memorandum. While the word "annual" was inadvertently omitted from Amendment No. 27 as filed, this was the result of an oversight, and did not reflect a substantive change. Even with this inadvertent omission, Section 11.2.9.1 does not specify the interval over which the cap will be applied, so the use of the intended annual interval is permitted by the ISO Tariff, as now in effect. To the extent that there is any ambiguity in the as-filed language, the Board Memorandum, which is publicly posted on the ISO Home Page, makes it clear that 11.2.9.1 establishes only an annual cap which can be modified at the discretion of the ISO Governing Board.

ISO's efforts to maintain the reliability of the ISO Controlled Grid. Southern Cities' demand for refunds should therefore be denied.

IV. Communications

Communications regarding this docket should be sent to the following individuals, whose names should be entered on the official service list established by the Secretary for this proceeding:

Charles F. Robinson
General Counsel
Roger E. Smith
Senior Regulatory Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
(916) 608-7135
Telecopy: (916) 608-7296

Edward Berlin
Kenneth G. Jaffe
Christine F. Ericson
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W.
Washington, D.C.
(202) 424-7500
Telecopy: (202) 424-7643

V. Conclusion

WHEREFORE, for the reasons discussed above, the Commission should summarily dismiss the complaint filed by the Southern Cities in this proceeding.

Respectfully submitted,

Charles F. Robinson
General Counsel
Roger E. Smith
Senior Regulatory Counsel
The California Independent
System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
(916) 608-7135
Telecopy: (916) 608-7296

Edward Berlin
Kenneth G. Jaffe
Christine F. Ericson
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W.
Washington, D.C. 20007
(202) 424-7500
Telecopy: (202) 424-7643

Dated: September 25, 2000