

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System) Docket No. ER98-3760-000
Operator Corporation)

California Independent System) Docket Nos. EC96-19-000
Operator Corporation) and ER96-1663-000
)
) [Not Consolidated]

JOINT INITIAL BRIEF ON ISSUE L.3 OF THE
CITIES OF REDDING, SANTA CLARA,
VERNON, ANAHEIM, AZUSA, BANNING,
COLTON AND RIVERSIDE, CALIFORNIA,
THE M-S-R PUBLIC POWER AGENCY,
AND DYNEGY POWER MARKETING, INC.

Bonnie S. Blair
Thompson Coburn LLP
700 14th Street, N.W.
Suite 900
Washington, DC 20005-2010
(202) 508-1000
(202) 508-1010 (fax)

Attorney for the Cities of
Anaheim, Azusa, Banning
Colton, and Riverside,
California

Arnold Fieldman
Joshua L. Menter
Miller, Balis & O'Neil, P.C.
140 19th Street, N.W.
Suite 700
Washington, DC 20036-6600
(202) 296-2960
(202) 296-0166 (fax)

Attorneys for the City
of Vernon, California

February 14, 2000

James D. Pembroke
Lisa S. Gast
Duncan, Weinberg, Genzer
& Pembroke, P.C.
1615 M Street, N.W.
Suite 800
Washington, D.C. 20036
(202) 467-6370
(202) 467-6379 (fax)

Attorneys for the Cities
of Redding, Santa Clara
and Palo Alto, California,
and the M-S-R Public Power
Agency

Joel D. Newton
Dynergy Power Marketing,
Inc.
905 15th Street, N.W.
Suite 510-A
Washington, DC 20005-2207
(202) 842-9180

TABLE OF CONTENTS

I.	PRELIMINARY STATEMENT AND INTRODUCTION	1
II.	EXECUTIVE SUMMARY	2
III.	ARGUMENT	5
	a. Is the ISO's Neutrality Adjustment sufficiently defined and should it be included as a formula rate in the ISO Tariff?	6
	b. Should there be a cap on the amounts that can be collected?	10
	c. What items are properly included in the Neutrality Adjustment?	12
	d. How should the charges be allocated?	16
IV.	CONCLUSION	17

TABLE OF AUTHORITIES

CASES

California Independent System Operator Corporation,
82 FERC ¶ 61,327 (1998) 5, 6

California Independent System Operator Corporation,
87 FERC ¶ 61,102 (1999) 1

Cambridge Elec. Light Co., 86 FERC ¶ 61,222 (1999) 7

Maine Yankee Atomic Power Co., 42 FERC ¶ 61,307 (1988) 7

Ocean States Power II, 69 FERC ¶ 61,146 (1994) 7

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System)	Docket No. ER98-3760-000
Operator Corporation)	
California Independent System)	Docket Nos. EC96-19-000
Operator Corporation)	and ER96-1663-000
)	
)	[Not Consolidated]

JOINT INITIAL BRIEF ON ISSUE L.3 OF THE
CITIES OF REDDING, SANTA CLARA,
VERNON, ANAHEIM, AZUSA, BANNING,
COLTON AND RIVERSIDE, CALIFORNIA,
THE M-S-R PUBLIC POWER AGENCY,
AND DYNEGY POWER MARKETING, INC.

The City of Redding, California ("Redding"), the City of Santa Clara, California ("Santa Clara"), the M-S-R Public Power Agency ("M-S-R") (collectively "Cities/M-S-R"), the City of Vernon, California ("Vernon"), the Cities of Anaheim, Azusa, Banning, Colton and Riverside, California ("Southern Cities") and Dynegy Power Marketing, Inc. ("Dynegy") (all collectively "Joint Proponents"), file their Joint Initial Brief in the above-captioned proceedings and say as follows:

I. PRELIMINARY STATEMENT AND INTRODUCTION

1. This Joint Initial Brief is filed in accordance with the Federal Energy Regulatory Commission's ("FERC" or "Commission") Orders of April 28, 1999, and January 20, 2000. California Independent System Operator

Corporation, 87 FERC ¶ 61,102 (1999) and 90 FERC ¶ 61,051 (2000). As required by those Orders, this Joint Initial Brief is prepared by the Cities/M-S-R, Vernon, the Southern Cities and Dynegy.

2. The Joint Proponents are intervenors in these proceedings. The Joint Proponents actively participated in the process which resulted in the filing of this Joint Initial Brief. That developmental process resulted in the elimination of hundreds of issues which had been identified by the ISO¹ and other participants arising out of the ISO Tariff and Protocols, various amendments to the ISO Tariff and Protocols and other filings by the ISO. Numerous issues, however, remain for Commission consideration and decision. To ease the Commission's burden in reviewing this record and making its decisions, the Joint Proponents have attempted to present their arguments succinctly, while providing the Commission with adequate information and argument upon which the Commission can act.

II. EXECUTIVE SUMMARY

3. The ISO, through its Amendment No. 6 to the ISO Tariff, proposes to pass through its Neutrality Adjustment an array of new charges including inadvertent energy interchanges, real time Inter-Zonal Congestion,

¹ Terms which are capitalized herein have the same meaning as reflected in the Master Definitions Supplement which is a part of the California Independent System Operator Corporation ("ISO") Tariff.

differences in the Loss calculations and other charges.

Formerly, the Neutrality Adjustment was intended to cure merely cash imbalances due to rounding.

4. The Joint Proponents submit that the Neutrality Adjustment should not be accepted as a formula rate in the ISO Tariff. Commission precedent requires that a formula rate be one which can be applied mechanically, using easily identifiable and verifiable data inputs. However, the inputs related to the items covered in the Neutrality Adjustment either constitute, or are developed from, data held by the ISO, and the ISO has steadfastly refused to disclose to stakeholders the components of the charge and how they are calculated. Until such time as the inputs to a Neutrality Adjustment formula are easily and accurately identifiable, the ISO's proposed Neutrality Adjustment is not appropriate for formula rate treatment.

5. However, if formula treatment is allowed, a cap of two mills per kWh should be placed on the amounts that can be collected under the Neutrality Adjustment. Since the charges covered by the Neutrality Adjustment are numerous and their verification is difficult, a cap is appropriate since it will allow certain flexibility in assessing charges related to the Neutrality Adjustment, while establishing reasonable limits on such charges. If the proposed two mill cap is reached, the ISO must file with

the Commission a proposal to collect amounts in addition to that limit.

6. With respect to the allocation of charges under the Neutrality Adjustment, a more refined allocation methodology is appropriate, particularly since the Neutrality Adjustment charges have been significant. Since the ISO has the data needed to propose a more detailed allocation, the ISO should prepare a report on the Neutrality Adjustment and its proposed allocation of those charges. In all events, however, costs related to Unaccounted for Energy ("UFE") should be excluded from the Neutrality Adjustment with respect to municipal utilities. UFE primarily involves distribution-related costs. Municipal utilities bear all of their own costs related to UFE and do not cause the UFE charges which arise from retail service outside their systems. Thus, to charge municipal utilities through the Neutrality Adjustment an inapplicable amount of UFE costs would result in an improper double charge.

III. ARGUMENT *

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 Cities, Cities/M-S-R, and City of Vernon, California ("Vernon")]

7. As originally proposed, the Neutrality Adjustment was a fudge factor aimed at curing cash imbalances due to rounding. Who can quarrel with this? However, on March 23, 1998, the ISO tendered for filing its proposed Amendment No. 6 to the ISO Tariff and Agreement ("Amendment No. 6"). Amendment No. 6 covered thirteen independent areas of modifications to the ISO Tariff, including changes to the Neutrality Adjustment.

8. By Order issued March 30, 1998, the Commission accepted, in part, Amendment No. 6. 82 FERC ¶ 61,327 (1998). The Commission recognized that its March

* For ease of Commission review, the arguments in this Initial Brief bear the designations utilized in the Joint Statement of Issues filed herein on January 4, 2000.

30, 1998 Order preceded the date for filing comments on Amendment No. 6, and specifically stated that it would address in a later order the substantive issues raised by the intervenors in their comments. See id., at 61,327, n.6.

9. Amendment No. 6 seeks to expand the use of the Neutrality Adjustment to include: Control Area inadvertent Energy interchanges; real time Inter-Zonal Congestion; differences in the calculation of Transmission Losses on imports in formulae for Imbalance Energy and UFE; imbalances in forward market schedules; and differences in settlements due to prior calculations for instructed and uninstructed deviations. See Amendment No. 6 at 70-71.

10. As noted below, the ISO's currently proposed Neutrality Adjustment is neither just nor reasonable and requires substantial revision.

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

11. The Joint Proponents submit that the delegation to the ISO, on a permanent or an interim basis, of the authority to determine the nature, level and allocation of charges related to the Neutrality Adjustment is an improper delegation of ratemaking authority to the ISO.

12. The Joint Proponents are aware, of course, that the Commission has previously approved tariff provisions which act as formula rates. However, for a

formula to be approved by the Commission, the methodology for determining rates and cost allocations must be specific.⁴ Further, the Commission has noted:

[O]ur acceptance of formula rates is predicated upon their fixed, predictable nature. That necessarily requires that the various components of the formula be predictable and the periodic adjustments to the specific numerical values assigned to the components be made in essentially a mechanical fashion.

Ocean States Power II, 69 FERC ¶ 61,146 at 61,552 (1994).

13. Examples of formula rates which have received Commission approval are: (1) fuel adjustment clauses where specifically identified classes and amounts of fuel, as specifically booked by the jurisdictional utility, are used in the formula; (2) rates which utilize as their input specific data from FERC Form 1 submissions; and (3) formula rates which are established by reference to externally derived and easily identifiable indicia, such as bond ratings. The common factor running through these formula rates is that the formula can clearly be applied and the data which comprise the inputs to the formula are easily and accurately identifiable.

14. Neither of these characteristics is present in the ISO's proposed Neutrality Adjustment. In Amendment

⁴ See Cambridge Elec. Light Co., 86 FERC ¶ 61,222 at 61,796 (1999); Maine Yankee Atomic Power Co., 42 FERC ¶ 61,307 at 61,923 (1988).

No. 6, the ISO proposed to include the following items, as described by the ISO, in the Neutrality Adjustment:

- **Control Area inadvertent Energy interchanges:** Scheduling Coordinator import and export Schedules at intertie points are "deemed" to equal the actual meter reads. This is because there are multiple schedules at each tie, and it is not possible to disaggregate hourly reads and assign them to individual schedules. This "deeming" results in zero import/export imbalances while there may be aggregate imbalances at the interties due to inadvertent flows. Unaccounted-for-Energy (UFE) is increased (or decreased) by these imbalances every hour and is charged to Scheduling Coordinators without any offsetting counter-charge (or credit).
- **Real time Inter-Zonal Congestion:** Inter-Zonal Congestion in real time will require resources to be dispatched in the importing and exporting Zones to mitigate the overload. To the extent that payments and charges in each separate Zone are not identical, there will be cash imbalances.
- **Differences in calculation of Transmission Losses on imports in formulae for Imbalance Energy and UFE:** Losses associated with import schedules are calculated in the import deviations formulae based on Scheduling Coordinators' schedules. Losses associated with import "actuals" are calculated as part of the UFE Settlement and are based on intertie metered values. Since the intertie metered values net import and export schedules, there may be smaller amounts of losses computed in UFE than in the Imbalance Energy

calculations. This also creates cash imbalances.

- **Imbalance in forward market schedules:** To the extent the sum of scheduled Generation, imports, Loads, exports and Inter-Scheduling Coordinator Trades is not balanced (yet within allowable ISO mismatch tolerance - which is set by the ISO at amounts between 1 MW and 20 MW as discussed in part K), the ISO may find UFE which is not offset by any Imbalance Energy charge or payment.
- **Differences in settlements due to price calculations for instructed and uninstructed deviations:** Payments for instructed Imbalanced Energy in the new Real Time Market pricing methodology will be paid based on the Energy "instructed." Any differences between this instruction and the meter reads from the Generation Units will be charged (or paid) at the Imbalance Energy Price for uninstructed deviations. The differences in these prices will cause revenue mismatches whenever units fail to meet ISO instructions.⁴

15. None of these items proposed for inclusion in the Neutrality Adjustment is susceptible to mechanical application or ease of identification. Indeed, nearly all of these items either constitute, or are developed from, data held by the ISO or devolve into fictions such as "deeming" exports and imports to equal actual meter reads (Control Area inadvertent Energy interchanges) or allowing

⁴ ISO Amendment No. 6 at 70-71.

energy imbalances to exist up to a 20 MW level (imbalances in forward market schedules).

16. The Joint Proponents submit that this data does not rise to the level of certainty, predictability and ascertainability which are necessary to permit the use of such data in a formula rate. The ISO should not be permitted to apply the Neutrality Adjustment as a formula rate.

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

17. As noted, in Amendment No. 6, the ISO added Section 11.2.9 to the ISO Tariff, incorporating a concept that the ISO had already included in SABP 3.1.1 of the Settlement and Billing Protocol. The ISO referred to the additional charges contemplated in proposed Section 11.2.9 as "Neutrality Adjustments." For the reasons described below, the ISO's ability to impose Neutrality Adjustments should not be unlimited, and the Commission should establish a cap on the Neutrality Adjustments under the ISO's proposal.

18. The ISO acknowledges that the potential impact of SABP 3.1.1 was not fully appreciated by Market Participants.⁴ In the SABP, the additional charges provided for in Section 3.1.1 were described in terms of adjustments to correct for revenue and payment differences

⁴ Id. at 71.

attributable to rounding of individual payments due to ISO Creditors and amounts due from ISO Debtors. As regards Amendment No. 6, however, the ISO identified five additional sources of revenue/payment imbalances that could be substantial, including Control Area inadvertent energy interchanges and costs associated with mitigation of real time Inter-Zonal Congestion. Attachment C to that Amendment listed more types of potential errors and accounting problems that the ISO would propose to deal with through SABP 3.1.1 Neutrality Adjustments. Under SABP 3.1.1, the net amounts of such Neutrality Adjustments will be allocated among all Scheduling Coordinators involved in transactions on the Trading Day in which revenue/payment imbalances arise in proportion to their demands during the Trading Day.

19. The ISO has correctly observed that SABP 3.1.1 has taken on increased significance with the identification of the many additional sources of potential imbalances requiring Neutrality Adjustments. The ISO had proposed to track such adjustments by category and promised to work with stakeholders to identify items that are significant enough to warrant development of mechanisms for apportioning cost responsibility in other ways.⁴ Although the ISO's commitment to monitor Neutrality Adjustments was a

⁴ See id.

step in the right direction, it is essential

that costs are charged properly to the Market Participants that cause them to be incurred.

20. The Commission should not permit the ISO to exercise the virtually unlimited discretion provided in SABP 3.1.1 and proposed Section 11.2.9 of the ISO Tariff. Although the Joint Proponents agree that the ISO should have some flexibility to address incidental revenue/payment imbalances, that flexibility should have reasonable limits. Significant cost items should be charged to the Market Participants that cause them to be incurred. The Joint Proponents respectfully urge the Commission to establish a cap on the Neutrality Adjustments that can be collected through SABP 3.1.1 and to require the ISO to file with the Commission any proposal to collect Neutrality Adjustments in excess of the established limits. A reasonable cap, at least initially, would be two mills per kWh.

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

21. As noted in Part III(a), supra, the ISO proposes to include a broad range of charges and costs in its Neutrality Adjustment. In response to a criticism that the ISO should not be allowed to collect one or more items in its Neutrality Adjustment barrel, the ISO would be expected to repeat its mantra that the ISO has no independent source of funding and that all expenses, costs

and charges must be paid in one fashion or another by the Market Participants. In such a venue, the distinctions between allocation of costs and inclusion of costs become blurred, since, according to the ISO, all costs must be borne by someone.

22. However, if the allocation provisions for Neutrality Adjustments under the ISO Tariff remain unchanged, one item of charge, i.e., Unaccounted for Energy ("UFE") charges, should be excluded from coverage in the Neutrality Adjustment and should be assessed elsewhere.^{2/}

23. Section 11.2.9(c) of the ISO provides that Neutrality Adjustment Charges will be "allocated amongst the Scheduling Coordinators who traded on that Trading Day pro rata to their metered Demand (including imports) in MWH of Energy for that Trading Day." In short, every ISO entity active in a given Trading Day will be allocated a portion of all Neutrality Adjustment charges, including UFE charges.

24. As this Commission has recognized, UFE charges "are attributed to meter measurement errors, energy theft, statistical load profile errors and distribution loss deviations."^{3/} Thus, a large portion (if not all) of the UFE charges relate to distribution level service.

^{2/} UFE matters are also covered in the brief filed respecting issue L.5.

^{3/} October 1997 Order at 61,522.

25. The significant element in understanding the proper assessment of the distribution-related UFE charges is that the municipal utilities receiving service from the ISO absorb all of their own distribution-related meter measurement errors, energy theft and distribution loss deviations. The municipal utilities receiving service from the ISO are interconnected utilizing revenue quality meters. That being the case, since power and energy cross the meters into the municipal utility's service territory, the municipal utility's cost obligations are established by those revenue quality meter readings. Any theft, losses, etc., which occur on the municipal utility's side of the revenue quality meter are completely absorbed, accounted for and paid for by such municipal utility with no support from any other entity. Once power and energy pass through the meter and into the municipal utility's service territory (thus being fully accounted for on the ISO Controlled Grid), all distribution-related energy losses are, as a physical and economic matter, the problem of the municipal utility and only the municipal utility.

26. With that understanding, it becomes evident why the inclusion of UFE charges in the Neutrality Adjustment is improper. The UFE, as reflected in the Section 11.2.9(c) allocation, relates to meter errors, energy losses, etc., primarily in the systems of the major investor-owned utilities in California. Unlike municipal

utilities with their territories set off by revenue quality meters, the energy losses, thefts, etc., of the investor-owned utilities reflect themselves as losses on the system which the ISO has the obligation to balance -- both electrically and monetarily. Thus, UFE losses, which cannot be attributed to retail service in the municipal utilities' service areas,² should be borne by the entities whose customers or service characteristics caused the losses -- primarily the investor-owned utilities.

27. To assess an across-the-board allocation through the Neutrality Adjustment of UFE charges related to energy losses, meter error, etc., on the investor-owned utility systems will result in a double charge on the municipal systems. Those municipal utilities will have absorbed, accounted for and paid for all of the distribution related losses on their own systems and the Neutrality Adjustment allocation under Section 11.2.9(c) of the ISO Tariff would assess a second and improper allocation of the investor-owned utilities' distribution related losses.

28. This assessment of a double charge to the municipal systems violates cost causation principles and is otherwise unjust and unreasonable. UFE charges should not be included in the Neutrality Adjustment.

² All such UFE losses have already been absorbed by the municipal utilities.

d. How should the charges be allocated?

29. In addition to the UFE matters discussed above, other allocation issues arise with respect to the Neutrality Adjustment, which are much akin to the substantial controversy surrounding the ISO's assessment of the Grid Management Charge ("GMC"). The Neutrality Adjustment allocation, as noted above, is allocated to all Scheduling Coordinators which traded on the Trading Day in question, pro rata to their metered Demand of Energy for that Trading Day. Thus, irrespective of whether the Neutrality Adjustment charges result from inadvertent Energy interchanges, real time Inter-Zonal Congestion or price calculations for instructed and uninstructed deviations, all Neutrality Adjustments are allocated in the same way. This gives rise to obvious and meritorious concerns that a more sophisticated allocation methodology is needed to properly account for the Neutrality Adjustment on a cost causation basis. These concerns are what caused the brawl in the GMC arena.

30. As long as the Neutrality Adjustment amounts are minor, a rough justice allocation of the lump sum on a metered Demand in MWH basis might be an appropriate administrative resolution. However, Neutrality Adjustment charges have not been small during the ISO's operations to date, and a more detailed allocation methodology is needed.

31. While a more defined allocation methodology may be needed, the Market Participants have inadequate data upon which to develop an informed opinion respecting the appropriate allocation of the Neutrality Adjustment into its various categories of cost components. In its Amendment No. 6 filing, at page 71, the ISO committed to "make publicly available, on a periodic basis, the amounts flowing through the Neutrality Adjustment by category." In addition to these efforts, however, the ISO should prepare a full analysis, akin to what has been required in the GMC controversy, which inter alia, identifies with specificity the level of the Neutrality Adjustment, the utilities in whose service area the Neutrality Adjustment's costs are being incurred, the categories of costs and a proposal for an equitable allocation of such costs on a cost causation basis.

IV. CONCLUSION

WHEREFORE, for the foregoing reasons, the Joint Proponents respectfully request that the Commission amend

the ISO Tariff and Protocols as above requested and
implement the proposals made above by the Joint Proponents.

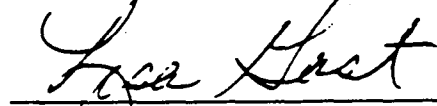
Dated: February 14, 2000

Respectfully submitted,



Bonnie S. Blair
Thompson Coburn LLP
700 14th Street, N.W.
Suite 900
Washington, DC 20005-2010
(202) 508-1000
(202) 508-1010 (fax)

Attorney for the Cities of
Anaheim, Azusa, Banning
Colton, and Riverside,
California



James P. Pembroke
Lisa S. Gast
Duncan, Weinberg, Genzer
& Pembroke, P.C.
1615 M Street, N.W.
Suite 800
Washington, D.C. 20036
(202) 467-6370
(202) 467-6379 (fax)

Attorneys for the Cities
of Redding, Santa Clara
and Palo Alto, California,
and the M-S-R Public Power
Agency



Arnold Fieldman
Joshua L. Menter
Miller, Balis & O'Neil, P.C.
140 19th Street, N.W.
Suite 700
Washington, DC 20036-6600
(202) 296-2960
(202) 296-0166 (fax)

Attorneys for the City
of Vernon, California



Joel D. Newton
Dynergy Power Marketing,
Inc.
805 15th Street, N.W.
Suite 510-A
Washington, DC 20005-2207
(202) 842-9180