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December 9, 2004

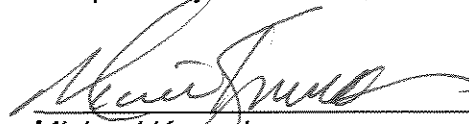
The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

**Re: Clarification in Response to Commission Letter of November 17,
2004, Docket Nos. ER01-889-012 and ER01-889-015**

Dear Secretary Salas:

The California Independent System Operator Corporation ("ISO") respectfully submits an original and fourteen copies of this filing in response to a letter received on November 17, 2004, from Ellen Schall, Assistant General Counsel, Markets, Tariffs and Rates. Two additional copies of this filing are enclosed to be date-stamped and returned to our messenger. If there are any questions concerning this filing please contact the undersigned.

Respectfully Submitted,



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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator) Docket Nos. ER01-889-012
Corporation) and ER01-889-015

**CLARIFICATION IN RESPONSE TO
COMMISSION LETTER OF NOVEMBER 17, 2004**

In response to a letter received on November 17, 2004 (“November 17 Letter”) from Ellen Schall, Assistant General Counsel, Markets, Tariffs and Rates for the Federal Energy Regulatory Commission (“FERC” or “Commission”), the California Independent System Operator Corporation (“ISO”),¹ hereby provides the following requested clarifications concerning the above-captioned docket. The active parties to this proceeding² have indicated to the ISO that they do not oppose the clarifications herein.

I. BACKGROUND

On November 7, 2001, the Commission issued an order, 97 FERC ¶ 61,151 (2001) (“November 7 Order”), in which it found that, although the California Department of Water Resources (“CDWR”) had represented that it was the creditworthy counter-party for the non-creditworthy UDCs, CDWR had yet to pay for the net short positions of the UDCs. Therefore, the Commission ordered

¹ Capitalized terms not otherwise defined herein are used as defined in Appendix A to the ISO Tariff, or in the Settlement Agreement and Release of Claims referred to in the text.

² The active parties for purposes of this document consist of: the ISO, the California Department of Water Resources, Pacific Gas & Electric, Southern California Edison, Reliant, the Modesto Irrigation District, and the Los Angeles Department of Water and Power.

the ISO to invoice CDWR for all transactions that it had entered into on behalf of PG&E and SCE within fifteen days of the date of that order.

On March 27, 2002, the Commission issued an order requiring that the ISO "re-invoice those gross amounts owed by DWR for all [CA]ISO transactions DWR entered into on behalf of the non-creditworthy UDCs. . . and provide a transparent means by which this Commission and other parties can determine whether the invoiced amounts were properly calculated." In response, the ISO submitted a compliance filing along with the gross invoices of PG&E and SCE, the net invoices of CDWR, and a worksheet and summary of these invoices.

In an order issued on November 25, 2002, 101 FERC ¶ 61,241 (2002) ("November 25 Order"), the Commission, in response to a motion filed by two California generators, found that the ISO had "misapplied the payment it received from CDWR for the period January 17-31, 2001" when it used the funds received by CDWR to pay the outstanding debts for the entire month of January 2001. *Id.* at P 16. The Commission directed the CAISO to "reallocate its pro rata disbursements for the entire month of January 2001, and disburse funds from DWR allocated for January 2001 to those that supplied power for the period January 17-31, 2001." The ISO intended to fulfill this requirement as part of its settlements rerun and invoicing process in the California refund proceeding. However, pursuant to the expressed desires of several parties, the ISO filed a compliance filing on October 3, 2003 setting forth its methodology for reallocation of CDWR funds for the month of January 2001. In that filing, the ISO explained that it did not intend to re-invoice and disburse amounts relating to January 2001

until such time as it issued invoices for the settlement rerun process that is currently taking place in the California refund proceeding.

The Commission, in the November 25 Order, also found that the compliance filing filed by the ISO pursuant to the March 27 Order was deficient in explaining whether or not it had properly calculated the amounts invoiced to CDWR on behalf of the net short position of the IOUs. Finding that there were material issues of fact as to whether the ISO had properly calculated amounts invoiced to CDWR, the Commission set for hearing the following issues:

an accounting and explanation to determine how the CAISO calculated that DWR owed \$3.6 billion (as the creditworthy party for the IOUs) to the CAISO markets for the period January 17, 2001 through July 31, 2001; an accounting and explanation to determine how the CAISO calculated that DWR was owed \$2.7 billion during this time period; how much interest, if any, is included in these amounts due; a determination on whether DWR has fully paid all of the CAISO invoiced amounts; and any other issues that might affect the calculation of the amount that the CAISO should have invoiced DWR.

On February 18, 2003 the ISO filed an unopposed motion to temporarily suspend the procedural schedule in this proceeding to allow the parties to focus on reaching a complete settlement and preparing an offer of settlement to file with the Commission. The Chief Administrative Law Judge granted the ISO's request and, on February 25, 2003, *suspended the procedural schedule until "otherwise ordered."* On May 14, 2004, the ISO, jointly with the active parties in this proceeding, filed a status report along with a request for continued suspension of the procedural schedule ("May 14 Status Report"). The parties stated that they continued to believe that settlement is the preferred means of

resolving the issues set for hearing by the Commission in this proceeding, but that negotiations would be greatly facilitated, and the likelihood of reaching a full settlement substantially increased, by awaiting the conclusion of the compliance process in the California refund proceeding, before attempting to conclude and file a settlement in this proceeding. The parties explained that this is the case because the amounts that the ISO has calculated that CDWR owed and was owed for the period January 17, 2001 through July 30, 2001, which are the subject of this proceeding, will necessarily change as a result of the settlement recalculations that the ISO must perform in order to implement the Commission's orders in the refund proceeding

In the November 17 Letter, Ms. Schall requests that the ISO, along with the parties of record in this proceeding, clarify two items. First, whether it is the intent of the parties to consider adjustments referenced in the letter "at the conclusion of the compliance process in the California refund proceeding or during the financial settlements stage of the refund proceeding." Second, whether the ISO believes that any Commission action is required at this time with respect to these dockets.

I. **CLARIFICATIONS**

A. **Adjustments Relating to the Payment of CDWR Funds for January, 2001 Will be Completely Overtaken By the Refund Rerun Process**

The first adjustment referred to in the November 17 Letter concerns the Commission's requirement in the November 25 Order that the ISO re-invoice the month of January 2001, in order to allocate funds received from CDWR to those suppliers who supplied power during the period January 17 through January 31, 2001. At this stage, the ISO believes that any adjustments relating to the payment of amounts from CDWR for the month of January 2001 will be entirely overtaken by the refund rerun process.

At the end of the refund rerun, the ISO plans to provide one aggregate invoice for each Market Participant that reflects the results of the refund rerun, as well as adjustments relating to fuel cost allowances, emissions offsets, and interest. This invoice will include adjustments for all of the months in the refund period, including January, 2001. Then, in what the November 17 Letter refers to as the "financial settlements stage" of the refund proceeding, the ISO will net the current outstanding balances for each Market Participant against the invoices that include all of the adjustments made during the refund process, taking into account the impact of global settlements reached in this proceeding. This netting process will result in one final balance for each Market Participant for the entire refund period; that is, the final amount that the Market Participant is owed by the ISO Market or owes the ISO Market for the refund period. The ISO will then

request that the Commission approve the ISO's calculation of the net balances, so that money can flow in accordance with the net balances.

Because this process is designed to comprehensively and finally address all financial activity for the refund period, it is unnecessary, and would introduce additional complications, to reflect in the refund process the "adjustments" for the month of January 2001 as set forth in the October 3 compliance filing. Neither the November 25 Order nor the ISO's October 3 allocation methodology actually changes the amounts owed to the ISO Market by Market Participants or owing to Market Participants from the ISO Market for the month of January 2001. Instead, the January 2001 adjustments reflected in the ISO's October 3 compliance filing relate only to priority of payment – *i.e.*, which suppliers should have been paid with funds already received from CDWR for the month of January 2001. Once the ISO invoices Market Participants for the refund process adjustments and nets these invoices against each Market Participant's then-current outstanding balance, there will no longer be any issue of which suppliers should be paid money received in the past by the ISO from CDWR. Instead, each Market Participant will be settled based on its current net balance with respect to the ISO Markets, and upon FERC approval, funds will flow so as to satisfy those balances.³ Finally, there is no need for a separate invoice with respect to CDWR funds for January, 2001, because all adjustments will be reflected on the invoices that the ISO will provide to Market Participants, as discussed above.

³ This issue is further mooted by the fact that three of the largest ISO Creditors for the refund period, Williams, Dynegy, and Duke, have settled their obligations relating to this period, allowing money to flow prior to the conclusion of the ISO's refund calculations.

B. The Issue of Whether the ISO Properly Invoiced CERS Should be Deferred Until the Commission Issues a Final Order on the Refund Proceeding

The second “adjustment” referenced in the November 17 Letter concerns the issue of whether the ISO properly invoiced CDWR for transactions that CDWR entered into on behalf of the California IOUs during the period January 17 through July 31, 2001. This matter is not an adjustment, but rather an issue of whether the ISO properly accounted for CDWR’s participation in the ISO Markets during the refund period. That is, how much does CDWR owe the ISO Market for this period, and how much is CDWR owed by the ISO Market for this period, as well as the amount of interest associated with these amounts.

As noted in the May 14 Status Report, the final answer as to whether the ISO properly accounted for CDWR activity during the refund period will not be known until such time as the ISO completes the refund rerun, along with all associated adjustments (e.g. interest, fuel cost allowances).⁴ For this reason, the parties requested in the May 14 Status Report that the Chief Judge suspend the procedural schedule in the ER01-889-012 proceeding such time as the Commission issues an order approving the ISO’s compliance filing in the California refund proceeding. The ISO continues to believe that this course of action is the most sensible, and presents the best opportunities for a negotiated resolution of this proceeding.

⁴ Moreover, the issue of how the ISO should account for energy provided by CERS to the ISO in real-time is still on rehearing before the Commission in the refund proceeding.

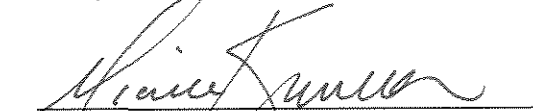
C. Additional Commission Action in this Proceeding is Not Required at this Time

No additional Commission action is necessary with respect to Dockets ER01-889-012 and ER01-889-015 at this juncture. The ISO will, however, immediately advise the Commission if this situation changes.

III. CONCLUSION

Wherefore, the ISO respectfully requests that the Commission accept the forgoing clarifications as responsive to the November 17 Letter.

Respectfully submitted,



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Gene L. Waas
Regulatory Counsel

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Dated: December 9, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served copies of the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, CA, this 9th day of December, 2004.



Gene L. Waas